DISCUSSION PAPER

Financial resources for risk events in superannuation

November 2022

Disclaimer Text

Contents

Executive summary

Superannuation fund members expect that RSE licensees, responsible for delivering retirement outcomes, will manage the operational risks of the business in a fair, equitable and prudent way. Doing so supports confidence in a trusted and stable superannuation industry. It is, therefore, incumbent on each RSE licensee to ensure it has ready access to equitably sourced financial resources to respond to, and rectify, the impacts of these operational risks.

Since 2013, the combination of s. 52(8)(b) of the *Superannuation Industry (Supervision) Act 1993* and *Prudential Standard SPS 114 Operational Risk Financial Requirement* (SPS 114) has required RSE licensees to maintain and manage financial resources to cover operational risks, while seeking to spread the impact fairly across different cohorts of members over time. SPS 114, with its operational risk financial requirement (ORFR), has been instrumental in ensuring RSE licensees set aside financial resources to make good any losses to members caused by operational risk events.

In response to significant industry evolution, supervisory insights and industry feedback, APRA intends to replace the existing SPS 114 with materially reshaped requirements.

At the core of these enhanced requirements will be a two-tiered model, consisting of:

- a baseline component, to ensure ready access to financial resources to fund recovery or exit activity; and
- an operational risk component, to spread the impact of operational risk fairly across different cohorts of members. The operational risk component will largely reflect the approach of the existing ORFR but with greater flexibility.

The enhanced requirements seek to widen the scope of permitted use, adopt a more sophisticated risk-based approach to the level of financial resources and reduce barriers to efficient use. APRA considers that, together, these enhancements will better support financial resilience in the superannuation sector.

Next steps

This discussion paper highlights APRA's proposed enhancements and welcomes views from various stakeholders across the superannuation industry. Submissions to this discussion paper are requested to be provided by no later than 17 March 2023. Information provided in response to this paper will inform revisions to the prudential framework, with consultation on the draft standard and guidance expected to commence in mid-2023.

Glossary

Draft CPS 190	Draft *Prudential Standard CPS 190 Financial Contingency Planning*
Draft CPS 230	Draft *Prudential Standard CPS 230 Operational Risk Management*
Draft CPS 900	Draft *Prudential Standard CPS 900 Resolution Planning*
ORFR	Operational risk financial requirement
RSE	Registrable superannuation entity
RSE licensee	Registrable superannuation entity licensee
SIS Act	*Superannuation Industry (Supervision) Act 1993*
SPS 114	*Prudential Standard SPS 114 Operational Risk Financial Requirement*
SPG 114	*Prudential Practice Guide SPG 114 Operational Risk Financial Requirement*
SPS 515	*Prudential Standard SPS 515 Strategic Planning and Member Outcomes*

Chapter 1 - Introduction

1.1 Background

The ability to respond to, rectify and reduce the likelihood of risks is critical to maintaining the financial resilience of the superannuation industry and delivering improved outcomes for members.

Section 52(8) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) requires RSE licensees to formulate, regularly review and give effect to a risk management strategy, including operational risks, relating to activities, or proposed activities, of the RSE licensee, to the extent they are relevant. RSE licensees are also required to maintain and manage financial resources to cover operational risk that relates to an RSE (the operational risk covenant). In 2013, APRA determined *Prudential Standard SPS 114 Operational Risk Financial Requirement* (SPS 114) to support the operation of the operational risk covenant.

Section 52(8) seeks to protect current members from losses due to operational risk events by[1]:

a) spreading the impact of operational risk fairly across different cohorts of members;

b) improving confidence in the superannuation system; and

c) increasing focus on risk management.

SPS 114 requires RSE licensees to determine and maintain a target amount of financial resources, reflecting the entity's operational risk profile, to be used to make good any losses to members caused by operational risk events that have materialised – this is referred to as the operational risk financial requirement (ORFR). SPS 114 also covers how these financial resources are managed and used, supplemented by documentation, review, and notification provisions.

To support greater safety and stability of the financial system, APRA has recently proposed a number of connected reforms, outlined in the sections that follow.

1.2 Consultation feedback to date

In November 2021, APRA issued a discussion paper, *Strengthening financial resilience in superannuation*, to gain further insights on the barriers to holistic and prudent management of financial resources, including questions on operational risk events and RSE licensees' approach to the ORFR.[2]

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[1] Refer to *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012* Explanatory Memorandum, page 26.

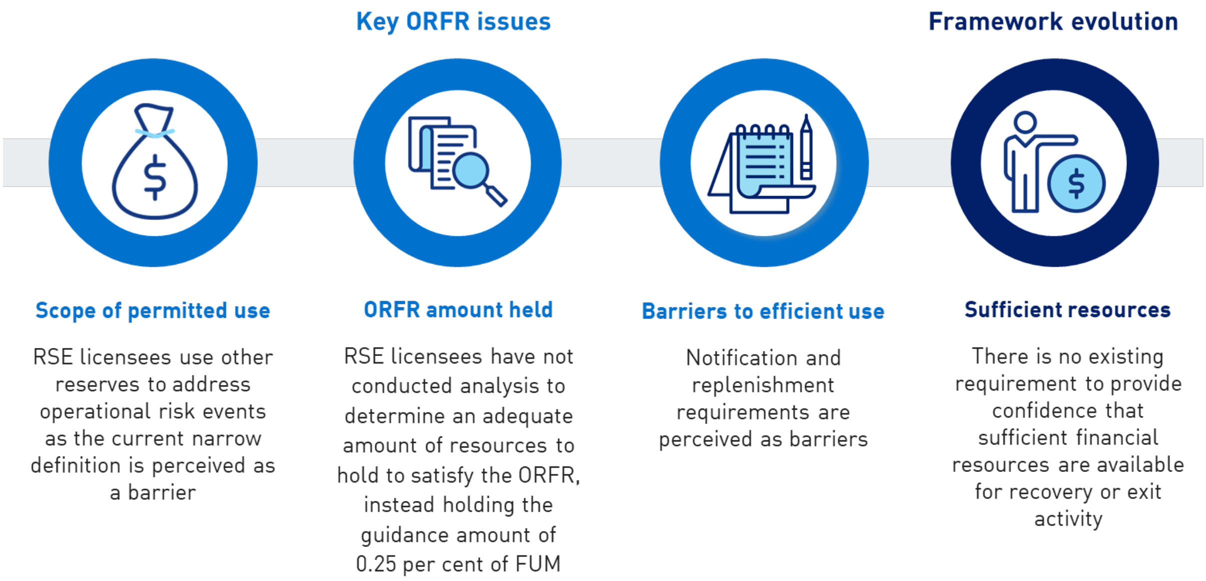
[2] [Strengthening financial resilience in superannuation](#) (Discussion paper, November 2021).

Submissions highlighted that while the ORFR helped to introduce rigour as the industry established operational risk reserves, it is no longer considered by industry stakeholders to be fit for purpose given significant evolution in the superannuation sector.

RSE licensees report reluctance to draw upon the financial resources held as part of the ORFR, citing notification and replenishment requirements as key barriers, instead using other reserves or trustee capital following operational risk events. This reduces the efficiency of the funds held to meet the ORFR and limits the ability to spread the impact of operational risk across different cohorts of members.

Submissions raised three key issues regarding the ORFR: the scope of permitted use, the amount held and barriers to efficient use, including replenishment and notification requirements. Additionally, since the introduction of SPS 114 in 2013, there has been significant evolution in the prudential framework, including the introduction of *Prudential Standard SPS 515 Strategic Planning and Member Outcomes* (SPS 515) in 2020 and reforms focused on trustee contingency and recovery planning. As a result, industry considers that SPS 114 could be enhanced to support a cohesive prudential framework that improves confidence in the superannuation system.

Figure 1: Key ORFR issues and scope to evolve framework



At present, SPS 114 restricts the use of ORFR financial resources to addressing member losses arising from operational risks that have materialised. This restricted use significantly limits the efficiency of money held to satisfy the ORFR and its ability to achieve the objectives of the operational risk covenant.

Under SPS 114, RSE licensees must determine a level of reserves to address operational risks, reflecting the size, business mix and complexity of their business operations. However, due to a range of factors, ORFR financial resources held by RSE licensees have largely followed the guidance set out in *Prudential Practice Guide SPG 114 Operational Risk Financial Requirement* (SPG 114) of 0.25 per cent of funds under management (FUM). As a result, money held to meet the ORFR increases linearly with FUM, rather than in line with risk. Over time, this approach has led to some RSE licensees holding very large ORFR financial resources.

In APRA's view, there is a compelling case to enhance the prudential framework to ensure members are equitably protected from the impacts of operational risk events by requirements that are better integrated with the evolved superannuation prudential framework.

1.3 Connected APRA reforms

APRA is pursuing related reforms which, in combination, seek to hold RSE licensees to a standard of financial management which better reflects their risk profile and the size and scale of their business, and require RSE licensees to have plans in place to protect members' funds. These are outlined below.

Connected reform	Objectives and focus	Timeline
Strategic planning and member outcomes	Proposes enhanced requirements to drive holistic and prudent management of financial resources. Enhancements intend to support the identification of where outcomes for members need to be improved and how such improvements will be made.	APRA released proposed strategic planning and member outcomes enhancements for consultation in August 2022.[3]
Superannuation transfer planning	Proposes requirements aimed at ensuring RSE licensees are better positioned to plan, undertake and receive transfers of members in both a crisis, and where they are not able to address sustainability, performance or cost issues through other remedial actions.[4]	APRA released proposed transfer planning requirements in November 2022.
Operational risk management	Proposes to strengthen the prudential framework through new and updated requirements covering the management of operational risk, business continuity and service providers for all APRA-regulated entities. SPS 114 complements *Prudential Standard CPS 230 Operational Risk Management* (CPS 230) by ensuring that RSE licensees have readily available financial resources to respond to, and address, operational risk events.	APRA released draft CPS 230 in July 2022.[5]

[3] *Strategic planning and member outcomes: Proposed enhancements* (Discussion paper, August 2022).

[4] *Superannuation transfer planning: Proposed enhancements* (Discussion paper, November 2022).

[5] *Strengthening operational risk management* (Consultation package, July 2022).

Financial contingency and resolution planning	Proposes requirements for entities, including RSE licensees, to develop and maintain plans for responding to stress that may threaten their viability, including plans for rebuilding financial resilience. Importantly, draft *Prudential Standard CPS 190 Financial Contingency Planning* (CPS 190) proposes to require RSE licensees to maintain access to sufficient financial resources to support the implementation of recovery and exit actions.	APRA released draft CPS 190 for consultation in December 2021.[6]

Figure 2: Current and expected upcoming releases for key superannuation prudential reforms

1.4 Purpose of this paper

This discussion paper seeks to collect views from RSE licensees regarding the proposed approach to replacing SPS 114 with enhanced obligations. It outlines the proposed model for risk-based financial resources held by RSE licensees, and seeks to gain feedback on the model, proposed purpose, calculation of amount and replenishment requirements for each component.

1.5 Next steps

APRA welcomes responses to this consultation by 17 March 2023. Following review of feedback and submissions, APRA intends to release a draft standard and guidance for consultation in mid-2023. Subject to the outcomes from consultation, APRA intends to finalise the revised SPS 114 in early 2024; the revised standard would commence on 1 January 2025, allowing sufficient time for implementation.

[6] Refer to Strengthening crisis preparedness (Consultation package, December 2021).

Chapter 2 - Proposed enhancements: Baseline+

2.1 The case for a new approach

Since the introduction of SPS 114 in 2013, the superannuation industry has become larger, with significant diversity and increased sophistication in the complexity of products made available to members. There are heightened risks in the external operating environment, such as pandemics, cyber risk and third-party service provider risks, exacerbated by the small number of critical service providers across the superannuation industry. This is in addition to the increasing complexity of the business operations of RSE licensees, including size, scale and insourcing.

While APRA has observed significant improvement in the maturity of RSE licensee risk management, very few RSE licensees have sought to adjust their ORFR target amounts to reflect changes in their risk profile (including risk mitigants and controls) and risk tolerance, as envisaged by SPS 114.

Feedback on the November 2021 discussion paper, and APRA's observations through its supervisory engagement, make clear that the current ORFR has not been operating as intended and requires enhancement to effectively mitigate operational risks faced by beneficiaries.

APRA proposes to require RSE licensees to hold financial resources to respond to operational risks in a more flexible and efficient way. APRA's goal is that RSE licensees are not only well-placed to manage operational risks affecting the RSE, but also have ready access to financial resources to do so in a fair and equitable manner.

The proposed amendments, in the form of a new Baseline+ model, seek to adopt a more sophisticated risk-based approach to the management of operational risk financial resources, informed by an RSE licensee's risk profile and risk appetite. A strong risk management framework will provide the foundation for calculating resources required to respond to potential operational risks.[7] This proposed model, in APRA's view, will address industry feedback and provide greater flexibility to allow for further evolution in RSE licensee practices – whilst better protecting members from the adverse financial impacts from operational risk events.

In addition to requirements to support s. 52(8) of the SIS Act, a baseline component of the Baseline+ model is informed by other prudential requirements relating to financial resilience and industry stability. The primary objective of this suite of connected requirements is to

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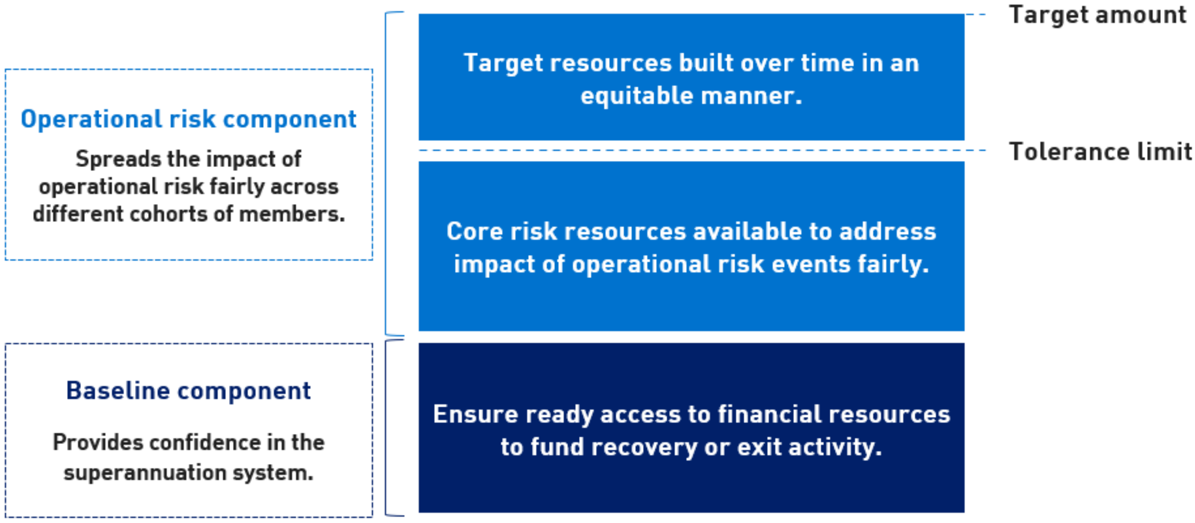
[7] As part of its risk management framework under *Prudential Standard SPS 220 Risk Management*, an RSE licensee must develop and maintain a risk management strategy, with a defined risk appetite supported by indicators and risks and business continuity plans.

promote greater confidence in the superannuation industry, whilst also spreading the impact of specific events fairly across cohorts of members.

2.2 The proposed Baseline+ approach

APRA's proposed Baseline+ model has two components: the baseline component and the operational risk component (refer to Figure 3).

Figure 3: APRA's proposed Baseline+ model



Whilst the baseline component and the operational risk component target different objectives, together they increase focus on risk management by incentivising RSE licensees to improve, allowing those with more robust frameworks to hold only necessary resources.

2.2.1 Baseline component

As outlined in Chapter 1, APRA is enhancing the prudential framework to require RSE licensees to have plans in place to protect members' funds, and support recovery or transfer activity if needed. It is vital that RSE licensees have adequate financial resources to enact these plans on a timely basis and with minimal financial impact on members. The proposed baseline component seeks to ensure that financial resources are available in times of need and the impact of these events is spread across different cohorts of members over a longer time horizon. Financial resources held to satisfy the baseline component would also satisfy the requirement in draft CPS 190 to maintain access to sufficient financial resources to support the implementation of recovery and exit actions contained in the contingency plan.

2.2.2 Operational risk component

The operational risk component is expected to be the primary source of funds to address the impact of operational risk events, and also serves as a buffer to the baseline component. APRA proposes to permit an RSE licensee to determine the amount held to satisfy the operational risk component, with a focus on addressing operational risks in an equitable manner. A broader definition of operational risk events will allow RSE licensees to better achieve this goal and, where possible, address operational risks before they adversely affect outcomes for members.

2.2.3 Overarching requirements

In addition to the specific requirements applying to the two components, APRA intends to enhance the prudential framework to require an RSE licensee to:

- ensure that the Board approves the amount held for the components;
- determine how the financial resources to meet each component are to be held and invested; and
- document the RSE licensee's approach in a strategy that is approved by the Board and reviewed at least annually or following a material change to its operational risk profile.

In line with the current ORFR requirements, financial resources held to meet the proposed requirements can continue to be held in a reserve within an RSE, trustee capital held by the RSE licensee or a combination of both.

Where financial resources are held within an RSE, the proposed requirements would continue to be subject to any rules on the use of reserves that may be set out under an RSE's governing rules.

2.2.4 Comparison of the baseline and operational risk components

Each component is defined by a different purpose and, as such, has different requirements. The detail of each component is discussed in Chapters 3 and 4, respectively.

	Baseline component (Chapter 3)	Operational risk component (Chapter 4)
Purpose	Designed to ensure there are sufficient financial resources readily available for recovery or exit activity.	Designed to spread the impact of operational risk fairly across different cohorts of members.
Key features	-	Target amount and tolerance limit.
Permitted use	Narrow scope: Recovery activity or transfer of members, service providers or change of RSE licensee.	Broad scope: Respond to the impact of operational risk, including investigation and remediation. May be used to act before an event occurs if consistent with the purpose.
Amount held	Maximum cost of implementing a trustee contingency or member transfer plan, or determined by basic calculation method.	Determined by the RSE licensee, who must be able to demonstrate the amount is appropriate based on individual risk profile and approach.
Liquidity	Common Equity Tier 1 Capital or equivalent.	Determined by the RSE licensee, which must be able to demonstrate the resources are held in an appropriate manner to address the purpose.
Replenishment	Short term replenishment requirement, if not used for exit.	Replenishment only required if below the tolerance, RSE licensee-led plan.

Chapter 3 - Baseline component

Baseline component

Protecting members from adverse events safeguards their financial interests and provides confidence in the superannuation system.

RSE licensees must have financial resources available to undertake business recovery plans or to implement a voluntary exit.

3.1 Role of the baseline component

An effective transfer of members, and recovery and resolution of the trustee company, is one that is funded ahead of time and with a sharp focus on the equitable treatment of members. To ensure that RSE licensees have sufficient financial resources to undertake these actions without members incurring unreasonable additional costs, APRA proposes to introduce the baseline component requirements. This means that an RSE licensee will have to maintain access to a specific pool of financial resources to enable these actions to take place.

3.2 Scope of permitted use

3.2.1 Current framework

Use of financial resources held to meet the ORFR target amount	
SPS 114	• An RSE licensee must only use ORFR financial resources to address an operational risk event, adjust the ORFR target amount and as needed in the event of a wind-up.
SPG 114	• Addressing an operational risk event may include justifiable costs arising as a result of the operational risk event, where the payment is essential to ensure that the loss is properly addressed and members do not incur large one-off expenses. • Provides examples of when the ORFR cannot be used, such as costs of upgrading IT systems or payments addressing losses relating to investment underperformance.

3.2.2 Proposed enhancements

To improve the efficiency of financial resources held by RSE licensees, APRA proposes to enhance the prudential framework to make clear that the baseline amount can be used to fund the:

- activation of a business continuity plan under draft CPS 230;
- activation of a financial contingency plan under draft CPS 190;
- activation of a resolution plan under draft CPS 900; and

- activation of a plan that involves the transfer or receipt of members under proposed enhancements to SPS 515.[8]

Each of these actions requires the RSE licensee to have ready access to financial resources to act quickly, thereby reducing undue financial impact on current members during the activation of the plan or transfer of members and assets while day-to-day business operations are maintained. This approach seeks to further improve confidence in the superannuation system. Where the action involves a transfer, it provides the receiving RSE licensee with confidence that the transferring RSE licensee has resources to transfer the assets, member records and other data in an orderly manner.

The potential enhancements are outlined below.

An RSE licensee must maintain and manage financial resources that enable the RSE licensee to:

a) **take actions to implement its business continuity plan, financial contingency plan, resolution plan or to undertake a transfer of members or a transfer of MySuper assets (baseline component); and**

b) fairly and equitably address the impact of operational risk on its beneficiaries (operational risk component).

3.3 Calculating the baseline amount

3.3.1 Current framework

Level of financial resources required	
SPS 114	• An RSE licensee must determine an ORFR target amount that reflects the size, business mix and complexity of the RSE licensee's business operations and is necessary to address operational risks (covering both risks identified in the risk management framework and those not specifically identified).
SPG 114	• An RSE licensee is expected to have an ORFR target amount equivalent to at least 0.25 per cent of funds under management (FUM), where FUM reflects the total of asset balances of each RSE within the RSE licensee's business operations. • An RSE licensee is to consider when more than this guideline amount may be appropriate, noting APRA considers it unlikely that there will be many circumstances where less than this guideline amount would be appropriate.

[8] Proposed enhancements relating to transfer plans were outlined in APRA's discussion paper *Superannuation transfer planning: Proposed enhancements*.

3.3.2 Proposed enhancements

To respond to the feedback that current requirements and guidance result in an inefficient amount of financial resources, APRA proposes to permit an RSE licensee to calculate an individual baseline amount for their business operations, using one of two methods:

a) *The RSE licensee-led method*: An amount that the RSE licensee can demonstrate as sufficient to allow it to undertake the actions covered by the baseline component while ensuring business operations are maintained; or

b) *The basic calculation method*: An amount based on the number of members, with the potential to be subject to a minimum dollar amount determined by APRA.

APRA expects the majority of RSE licensees would seek to adopt the RSE licensee-led method, as it is more likely to result in an amount of money that more appropriately reflects the risk profile and risk appetite of the RSE licensee's business operations. Should an RSE licensee not have the capability to calculate the baseline amount using the RSE licensee-led method, it would be open to the RSE licensee to adopt the basic calculation method instead.

APRA intends to draw on relevant international precedents to inform the basic calculation method. In the United Kingdom, The Pensions Regulator imposes two financial sustainability requirements on Master Trusts[9], including an obligation to hold financial reserves sufficient to maintain operations for 6 to 24 months (where the period is determined by The Pensions Regulator) following a trigger event.[10] These financial resources may be calculated using a detailed or basic calculation. For The Pensions Regulator model, the basic calculation is £75 per member.

By comparison, the Republic of Ireland has introduced a similar, but simpler approach, whereby Master Trusts are required to have access to €70 per member, subject to a floor of €100,000. The role of the floor is to capture those costs of dealing with a trigger event that are likely to be common to all master trusts, for example, legal and accounting expenses.

Given the importance of the baseline amount and the cost of implementing contingency plans, APRA is considering the appropriateness of requiring a minimum amount to ensure that all members are protected. This minimum amount might represent a prudent estimate of the minimum costs of exit and would be able to be adjusted or excluded by APRA in exceptional circumstances.

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[9] UK master trusts, regulated by The Pensions Regulator, are accumulation products that have a similar risk profile to RSEs.

[10] Trigger events cover ten key risk scenarios and are defined in UK legislation. The most relevant triggers to the risks to RSE licensees and their business operations being: (1) The Trustee decides a scheme is at risk of failure and cannot continue in its current state; (2) The Trustee makes a decision to wind-up or a wind-up event occurs; and (3) Action is taken by the regulator that may necessitate a wind- up or transfer of the fund, including withdrawal of authorisation.

3.4 Liquidity and replenishment requirements

3.4.1 Current framework

Replenishing financial resources to meet the ORFR target amount	
SPS 114	• An RSE licensee must determine a Board-approved tolerance limit below the ORFR target amount indicating when action will be taken to replenish financial resources, with a replenishment plan documented in the ORFR strategy. • An RSE licensee's replenishment plan must seek to replenish resources within a reasonable period in a manner that ensures that the RSE licensee acts fairly in dealing with beneficiaries. • The amount held to meet the ORFR requirement must be separately identifiable from member accounts and be available to address operational risks in a timely manner. When trustee capital is used to meet the ORFR target amount, it must be held in a form that is equivalent to Common Equity Tier 1 Capital.
SPG 114	• The ORFR tolerance limit is intended to enable an RSE licensee to manage immaterial fluctuations below the ORFR target amount without the need for a replenishment plan. • A replenishment plan may incorporate an anticipated payment from a compensation arrangement on which an RSE licensee believes it can reasonably rely. • When planning an investment strategy for the ORFR, it is expected assets have an appropriate risk profile and be sufficiently liquid.

3.4.2 Proposed enhancements

To ensure that financial resources are readily available to support the actions proposed to be covered by the baseline component, APRA proposes to make clear that financial resources held for the purposes of the baseline component can continue to be held either in a reserve in the RSE or as trustee capital that is equivalent to Common Equity Tier 1 Capital or in a combination of both.

Where the financial resources are held in a reserve in the RSE, APRA expects an RSE licensee would ensure that the assets in the reserve provide an unrestricted commitment of financial resources to address operational risks in a timely manner.

The potential requirements are outlined below.

Where an RSE licensee holds the financial resources for the baseline component in an RSE:

a) the financial resources must be separately identifiable from member accounts and reserves in the RSE for other purposes; and

b) the RSE licensee must provide an unrestricted commitment of financial resources to undertake business recovery plans or to implement an orderly exit in a timely manner.

Where an RSE licensee holds the baseline component financial resources as trustee capital, the financial resources must be held in a form that is equivalent to Common Equity Tier 1 Capital.

Where an RSE licensee takes into account another source of unrestricted financial resources in their baseline component financial resources, the RSE licensee must be able to demonstrate why they consider that source to be appropriate for meeting the requirement of this Prudential Standard.

Where an action involves only a partial transfer of members, or involves recovering the position of the trustee company, it is important that the baseline amount is replenished to provide continued support for the remaining members. APRA therefore proposes that an RSE licensee will be required to replenish the financial resources held for the baseline component within three years.

Where undertaking a transfer of members results in all members being transferred out of the RSE licensee's business operations, no replenishment will be required.

The potential requirements are outlined below.

Where an RSE licensee uses some or all of the baseline amount to activate a recovery or transfer plan, an RSE licensee must implement a replenishment plan and ensure that the baseline amount is replenished within 3 years.

Chapter 4 - Operational risk component

Operational risk component	
	If RSE licensees do not have financial resources to respond to and rectify operational risks, members are exposed to greater risk of lower savings in retirement. Prudent operational risk management will allow for improved safety for members and greater confidence in the superannuation system.

4.1 Role of the operational risk component

The operational risk component is intended to support an RSE licensee managing its financial resources in a flexible way that enables it to spread the impact of operational risk across different cohorts of members in an equitable manner. To this end, APRA expects that an RSE licensee would use the operational risk component as the primary source of financial resources to manage the impact of operational risk, supported by appropriate controls.

These proposed requirements are intended to be made for the purposes of section 52(8)(b) of the SIS Act.

4.2 Scope of permitted use

4.2.1 Current framework

Use of financial resources held to meet the ORFR target amount	
SPS 114	• An RSE licensee must only use ORFR financial resources to address an operational risk event, adjust the ORFR target amount and as needed in the event of a wind-up.
SPG 114	• Addressing an operational risk event may include justifiable costs arising as a result of the operational risk event, where the payment is essential to ensure that the loss can be absorbed and members do not incur large one-off expenses. • Provides examples of when the ORFR cannot be used, such as costs of upgrading IT systems or payments addressing losses relating to investment underperformance.

4.2.2 Proposed enhancements

Submissions to the November 2021 discussion paper highlighted the unintended consequences arising from the current permitted uses for the ORFR.

APRA proposes to respond to this feedback by taking a forward-looking and risk-based approach to the ORFR, allowing RSE licensees to address potential problems before they adversely affect members. Increasing the scope of permitted use will assist APRA to ensure the Australian community is protected.

APRA, therefore, proposes to enhance the prudential framework with an amended definition of 'operational risk event' such that it aligns with the equivalent definition in the explanatory memorandum (EM) to the enabling legislation. This definition states that operational risk is the risk that a superannuation fund may suffer loss due to inadequate or failed internal processes, people and systems or from external events, excluding investment and market risk for fund investments.[11]

The new definition of 'operational risk event' is intended to expand the allowable uses to include investigations, remediations and mitigation related activities to address operational risk within the RSE, as well as encourage operational risk prevention activities to reduce the likelihood of reoccurrence of operational risk events. This would allow the ORFR to fulfil its intended purposes of supporting an increased focus on risk management whilst spreading the impact fairly and equitably across different cohorts of members.

The broader scope of permitted use would also improve alignment with the proposed operational risk requirements in draft CPS 230, ensuring that the operational risk financial resources cover the full range of operational risks relating to the RSE identified in an RSE licensee's risk management framework.[12]

The potential requirements are outlined below.

An RSE licensee must maintain and manage financial resources to enable the RSE licensee to:

a) take actions to implement its business continuity plan, financial contingency plan, resolution plan or to undertake a transfer of members or a transfer of MySuper assets (baseline component); and

b) fairly and equitably address the impact of operational risk on its beneficiaries (operational risk component).

[11] Refer to Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012.

[12] Draft CPS 230 states that an APRA-regulated entity must manage its full range of operational risks, including but not limited to legal risk, regulatory risk, compliance risk, conduct risk, technology risk, data risk, reputational risk and change management risk.

4.3 Calculating the operational risk amount

4.3.1 Current framework

Calculating the ORFR target amount	
SPS 114	• An RSE licensee must determine an ORFR target amount that reflects the size, business mix and complexity of the RSE licensee's business operations and is necessary to address operational risks (covering both risks identified in the risk management framework and those not specifically identified).
SPG 114	• An RSE licensee is expected to have an ORFR target amount equivalent to at least 0.25 per cent of funds under management (FUM), where FUM reflects the total of asset balances of each RSE within the RSE licensee's business operations. • An RSE licensee is expected to consider when more than this guideline amount may be appropriate, noting APRA considers it unlikely that there will be many circumstances where less than this guideline amount would be appropriate.

4.3.2 Proposed enhancements

Current SPS 114 requires an RSE licensee to maintain an ORFR target amount and a tolerance limit.

As these have proven to be useful to drive RSE licensee discipline, APRA intends to retain these features in the context of the operational risk component. The target amount would be the optimum amount that the RSE licensee considers would address the expected impact of operational risks occurring in the normal course of business, whilst leaving a buffer that facilitates longer-term replenishment approaches and achieves the fairness and equity objectives. The buffer would also be available to respond where the baseline amount is insufficient.

The tolerance limit would continue to indicate when the financial resources held are materially below the optimum amount and the RSE licensee must respond.

While the risk of RSE licensees not having enough financial resources to rectify operational risk events is clear, holding more than required can come at a cost to members. To date, many RSE licensees have ensured compliance with the ORFR by following the expectation in SPG 114 (0.25 per cent of FUM). As FUM continues to increase, amounts held to meet the ORFR have increased over and above the risks arising in the normal course of many RSE licensees' business operations.

APRA, therefore, proposes to remove the guidance amount for the ORFR from SPG 114.

The potential requirements are outlined below.

For the operational risk management component, an RSE licensee must:

a) determine and hold a target amount of financial resources that reflects the operational risk profile of the RSE licensee's business operations (operational risk management target amount); and

b) determine a tolerance limit that reflects the level below which the RSE licensee must implement steps to replenish the financial resources.

4.4 Liquidity and replenishment requirements

4.4.1 Current framework

Replenishing financial resources to meet the ORFR target amount	
SPS 114	• An RSE licensee must determine a Board-approved tolerance limit below the ORFR target amount indicating when action will be taken to replenish financial resources, with a replenishment plan documented in the ORFR strategy. • An RSE licensee's replenishment plan must seek to replenish resources within a reasonable period in a manner that ensures that the RSE licensee acts fairly in dealing with beneficiaries. • The amount held to meet the ORFR requirement must be separately identifiable from member accounts and be available to address operational risks in a timely manner. When trustee capital is used to meet the ORFR target amount, it must be held in a form that is equivalent to Common Equity Tier 1 Capital.
SPG 114	• The ORFR tolerance limit is intended to enable an RSE licensee to manage immaterial fluctuations below the ORFR target amount without the need for a replenishment plan. • A replenishment plan may take into account an anticipated payment from a compensation arrangement on which an RSE licensee believes it can reasonably rely. • When planning an investment strategy for the ORFR, it is expected assets have an appropriate risk profile and be sufficiently liquid.

4.4.2 Proposed enhancements

Submissions to the November 2021 discussion paper highlighted that the replenishment requirements have resulted in unintended consequences, primarily acting as a barrier to effectively spreading the impact of operational risk events across different cohorts of members. There were divergent views about the appropriate time period for replenishment plans, with there being limited appetite for not meeting the tolerance amount.

To remove these barriers, APRA proposes to enhance the prudential framework to:

- make clear that the duration of a replenishment plan will need to be informed by the amount required to be replenished and the risk profile of the RSE licensee, noting that short-term replenishment plans may not achieve the objective to spread risk in an equitable manner; and
- make clear that the RSE licensee's tolerance limit must be used to trigger a Board deliberation as to whether additional steps should be taken to replenish the reserve.

The primary purpose of holding financial resources to address operational risk is to ensure the availability of funds as and when needed. As such, in line with the current guidance, APRA proposes to continue to allow RSE licensees to implement investment strategies for the operational risk component, provided sufficient liquidity is maintained and the risk profile is appropriate for the purposes of these funds.

The potential requirements are outlined below.

Where the level of financial resources held for the operational risk management component falls below the tolerance limit, an RSE licensee must implement a replenishment plan and replenish the level of financial resources to the target within a period that the RSE licensee determines is equitable and minimises the risk of adverse member outcomes.

4.5 Notification requirements

4.5.1 Current framework

ORFR notification requirements	
SPS 114	• An RSE licensee must notify APRA, within 10 business days, in certain circumstances, including where the ORFR target amount is to be adjusted, financial resources have fallen below the tolerance limit, the RSE licensee is aware that a material amount of financial resources will need to be used, or where an RSE licensee-determined material trigger event has occurred.
SPG 114	• As part of its incident management process, an RSE licensee may determine a series of material trigger events that act as a risk management control by providing early warning and a means of escalation for matters that may require a decision by the RSE licensee and notification to APRA.

4.5.2 Proposed enhancements

The notification requirements in SPS 114 sought to collect information to gain insights into operational risk across the industry. Unfortunately, due to limited use of the ORFR, this data has not been generated as originally anticipated.

To better support gathering industry-wide operational risk insights, APRA proposes to remove the existing notification requirements from SPS 114. RSE licensees will remain subject to existing breach notification requirements, and APRA will seek to collect further operational risk data through enhancements to the reporting framework. Reporting requirements will be consulted on as part of the Superannuation Data Transformation: Phase 2 project. This data would be used to provide a greater evidence base for the calculation of the operational risk component and assist in identifying areas for enhancement.

Chapter 5 - Consultation

5.1 Request for submissions

APRA invites written submissions on the proposals set out in this discussion paper. Written submissions should be sent to superannuation.policy@apra.gov.au by 17 March 2023 and addressed to the General Manager, Policy, APRA.

Following review of feedback and submissions received, APRA plans to release a draft standard in mid-2023 for consultation. The new prudential requirements would come into effect from 1 January 2025.

5.2 Consultation questions

APRA welcomes feedback on all aspects of the proposals in this discussion paper. The following questions are intended to identify specific areas for feedback that would assist APRA in developing the requirements. They are intended to support, but not limit, responses.

Questions	
Baseline+ model	1. What changes, if any, would enhance the proposed scope of permitted use for the baseline component and for the operational risk component? 2. What legal or practical restrictions may impede RSE licensees from implementing or complying with the proposed Baseline+ model? 3. Are there any likely unintended consequences of the model or individual proposed requirements?
Baseline component	4. Will RSE licensees likely have sufficient capability to calculate the proposed baseline component, and what methodology would be used? 5. What is the likely level of the baseline component? 6. How often should the baseline amount be reviewed and why? 7. What are your views on providing a basic calculation option, with the amount held linked to member numbers? Are there any other methods that would be more efficient or better targeted? 8. Should APRA set a minimum amount for the baseline component or would this lead to unintended consequences?
Operational risk component	9. Would RSE licensees have the capability to determine an appropriate target amount for the operational risk component? 10. What controls may be necessary to address the risk that the target amount is not efficient or not prudent (too high or too low)? 11. How should a maximum timeframe for the replenishment of the operational risk component to its target amount be set?

5.3 Request for cost-benefit analysis information

APRA requests that all interested stakeholders use this consultation opportunity to provide information on the compliance impact of the proposed changes and any other substantive costs associated with the changes. Compliance costs are defined as direct costs to businesses of performing activities associated with complying with government regulation. Specifically, information is sought on any increases or decreases to compliance costs incurred by businesses as a result of APRA's proposals.

Consistent with the Government's approach, APRA will use the methodology behind the Commonwealth Regulatory Burden Measure to assess compliance costs. This tool is designed to capture the relevant costs in a structured way, including a separate assessment of upfront costs and ongoing costs. It is available at https://rbm.obpr.gov.au/.

Respondents are requested to use this methodology to estimate costs to ensure the data supplied to APRA can be aggregated and used in an industry-wide assessment. When submitting their costs assessment to APRA, respondents are asked to include any assumptions made and, where relevant, any limitations inherent in their assessment.

Feedback should address the additional costs incurred as a result of complying with APRA's requirements, not activities that entities would undertake regardless of regulatory requirements in their ordinary course of business.

5.4 Important disclosure requirements – publication of submissions

All information in submissions will be made available to the public on the APRA website unless a respondent expressly requests that all or part of the submission is to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as confidential in a separate attachment.

Submissions may be the subject of a request for access made under the *Freedom of Information Act 1982* (FOIA). APRA will determine such requests, if any, in accordance with the provisions of the FOIA. Information in the submission about any APRA-regulated entity that is not in the public domain and that is identified as confidential will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and will therefore be exempt from production under the FOIA.