



# DISCUSSION PAPER

## Financial resources for risk events in superannuation

November 2022

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# Executive summary

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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

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

# Chapter 1 - Introduction

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## 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<sup>1</sup>:

- 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.<sup>2</sup>

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<sup>1</sup> Refer to *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012* Explanatory Memorandum, page 26.

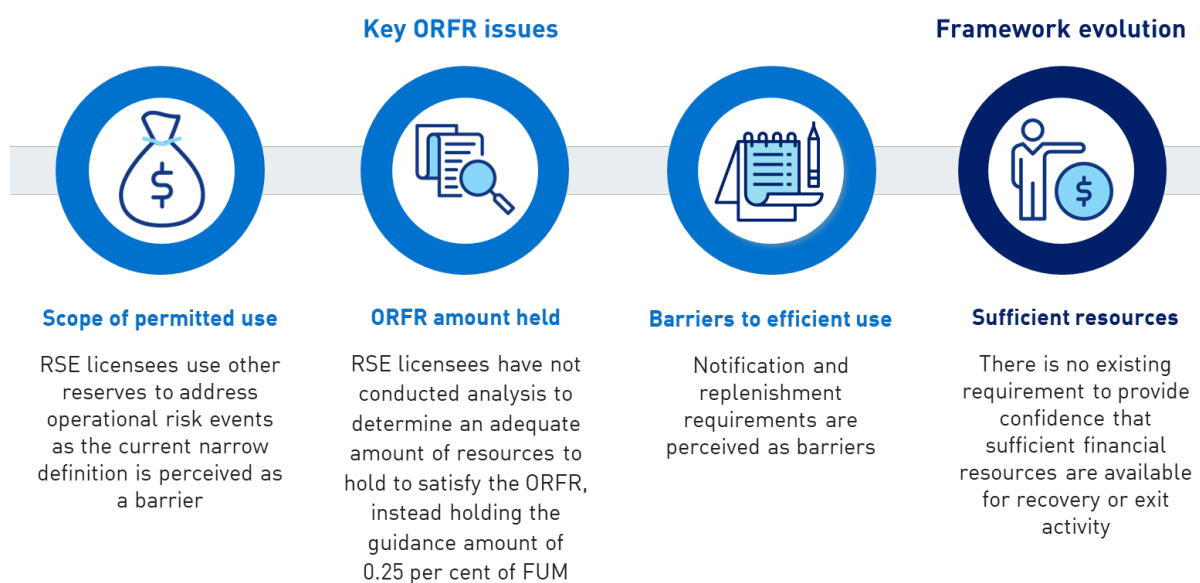
<sup>2</sup> [Strengthening financial resilience in superannuation](#) (Discussion paper, November 2021).

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
<b>Strategic planning and member outcomes</b>	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. <sup>3</sup>
<b>Superannuation transfer planning</b>	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. <sup>4</sup>	APRA released proposed transfer planning requirements in November 2022.
<b>Operational risk management</b>	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 <i>Prudential Standard CPS 230 Operational Risk Management</i> (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. <sup>5</sup>

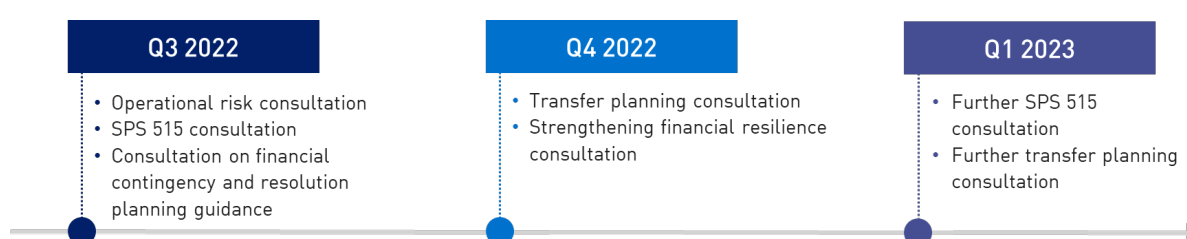
<sup>3</sup> [Strategic planning and member outcomes: Proposed enhancements](#) (Discussion paper, August 2022).

<sup>4</sup> [Superannuation transfer planning: Proposed enhancements](#) (Discussion paper, November 2022).

<sup>5</sup> [Strengthening operational risk management](#) (Consultation package, July 2022).

<b>Financial contingency and resolution planning</b>	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 <i>Prudential Standard CPS 190 Financial Contingency Planning</i> (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. <sup>6</sup>
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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.

<sup>6</sup> Refer to [Strengthening crisis preparedness](#) [Consultation package, December 2021].



















# 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	<ul style="list-style-type: none"><li>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.</li></ul>
SPG 114	<ul style="list-style-type: none"><li>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.</li><li>Provides examples of when the ORFR cannot be used, such as costs of upgrading IT systems or payments addressing losses relating to investment underperformance.</li></ul>

### 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.<sup>11</sup>

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.<sup>12</sup>

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).**

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<sup>11</sup> Refer to [Superannuation Legislation Amendment \(Trustee Obligations and Prudential Standards\) Bill 2012](#).

<sup>12</sup> 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.















