



General Manager, Policy  
Australian Prudential Regulation Authority (APRA)  
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17 March 2023

Dear Sir/Madam,

**Submission feedback on Discussion Paper: Financial resources for risk events in superannuation**

We are pleased to have the opportunity to provide feedback on the proposals in the discussion paper, "*Financial resources for risk events in superannuation*" (November 2022), under consultation by Australian Prudential Regulation Authority (**APRA**) in relation to developing the new requirements to replace the existing *Prudential Standard SPS 114 Operational Risk Financial Requirement (SPS 114)*.

**Executive Summary**

We support the objectives of APRA's proposal to adopt a more sophisticated risk-based approach for RSE licensees to determine the level of financial resources required to be set aside for operational risk events, while also widening the scope of permitted use, and reducing the barriers to its efficient use.

We support the principle of the Baseline+ model to meet the objectives of spreading the operational risk fairly across different cohorts of members and to provide confidence in the superannuation system. This model would allow RSE licensee(s) to align the amount of financial resources held with the risks within each RSE (given that operational risk does not generally increase on a linear basis with the number of members or funds under management (FUM)).

We support the proposal to amend the definition of 'operational risk event' 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.

However, we suggest that further guidance is required to define what would be permissible activities under this expanded definition. This being to reduce the risk of inadvertently using the operational risk component reserve for a purpose inconsistent with APRA's intention, and to ensure consistency across the industry.

We suggest that a principles-based approach (rather than a prescriptive approach) be adopted for both the baseline and operational risk components. This being to avoid unintended consequences that could emerge with a prescriptive approach, including an inability for prescriptive requirements to adequately address differing risk profiles of RSEs that vary according to their operating model.

In reviewing the proposed enhancements, the areas requiring further guidance and clarification include:

- (a) **Consistency**, how consistency will be ensured across RSEs on a risk adjusted basis? How would different operating models be assessed (e.g. RSEs that are self-administered v outsourced)?



- (b) **Transition**, the period to transition to the new operating model and how any potential surplus of existing ORFR reserves should be transferred or utilised? How will additional reserve be raised if there are insufficient ORFR?
- (c) **Reporting**, would the adequacy of reserves be reported to members?
- (d) **Supervision and assurance**, how is APRA proposing to supervise compliance and what assurance activities would be required under the proposed model?

We recommend that early adoption of this new standard is permitted at the option of each RSE to help mitigate the risk of demand peaking across RSE's simultaneously.

We understand APRA's proposed enhancements and view these changes positively in better supporting financial resilience in the superannuation sector. However, we believe some enhancements will require further development. Therefore, we have provided responses to the specific discussion paper questions raised by APRA. Please refer to **Appendix 1** for our detailed comments.

We would be pleased to discuss our comments with APRA. If you wish to do so, please contact [REDACTED] on [REDACTED]

Yours faithfully,

[REDACTED]  
Deputy Chief Financial Officer

**17 March 2023**

## APPENDIX 1

Response to Discussion Paper questions raised by APRA's Discussion Paper (*Financial resources for risk events in superannuation, November 2022*), are detailed below:

Topic	Questions	Feedback response
<b>Baseline + model</b>	1. What changes, if any, would enhance the proposed scope of permitted use for the baseline component and for the operational risk component?	a. We suggest APRA provide further guidance to: <ol style="list-style-type: none"> <li>i. clarify how the use of the baseline component to fund the <i>receipt</i> of members under proposed enhancements to SPS 515 would be an appropriate use of the reserve given its purpose to ensure there are sufficient financial resources readily available for recovery or exit activity.</li> <li>ii. clarify the scope of permitted use for the operational risk components (with specific examples), particularly in regard to how this could be used to act before an event occurs so as to reduce the risk of an inadvertent breach and ensure consistency across the industry.</li> <li>iii. confirm the transition timeframe and permitted use of any surplus arising from the transition from the current operational risk financial requirement (<b>ORFR</b>) reserve to the new Baseline + model, whilst noting the need to ensure equity across different cohorts of members.</li> </ol>
	2. What legal or practical restrictions may impede RSE licensees from implementing or complying with the proposed Baseline+ model?	a. We envisage that the proposed RSE licensee-led method will require additional resources to perform the risk-based capital modelling and that this will increase demand for this skillset in the market more broadly.  b. We recommend that early adoption of this new standard is permitted at the option of each RSE to help mitigate the risk of demand peaking across RSE's simultaneously.

Topic	Questions	Feedback response
	<p>3. Are there any likely unintended consequences of the model or individual proposed requirements?</p>	<p>a. Maintaining two separate components may lead to an increase in operational and compliance costs. Further guidance is required on whether enhanced assurance processes across line 3 and 4 assurance would be required, therefore potentially increasing the cost to members.</p> <p>b. It would be helpful to understand how APRA intends to supervise the implementation of and compliance with the new model framework to ensure consistency across the industry. Further guidance in this regard would also help to minimise any material revisions required to the frameworks by RSE licensees after implementation. For example, this information should include:</p> <ul style="list-style-type: none"> <li>i. requirements for conducting audit/assurance activities to confirm compliance;</li> <li>ii. any regulatory reporting to APRA (and the frequency of such reporting); and</li> <li>iii. any proposed 'scorecard' approach for comparability of models across the industry.</li> </ul> <p>c. Further clarity is required on how any drawdowns from the Baseline and Operational Risk components would be considered under other regulatory requirements, such as the treatment under RG97 fee disclosure purposes.</p>

## APPENDIX 1 (continued)

Response to Discussion Paper questions raised by APRA’s Discussion Paper (*Financial resources for risk events in superannuation, November 2022*), are detailed below:

Topic	Questions	Feedback response
<b>Baseline component</b>	4. Will RSE licensees likely have sufficient capability to calculate the proposed baseline component, and what methodology would be used?	<ul style="list-style-type: none"> <li>a. We support APRA’s proposal to allow RSE licensee(s) the option to adopt either one of the two proposed methods to calculate the appropriate baseline amount: (a) RSE licensee-led method, based on risk exposures of the RSE’s business operations; or (b) an alternative basic calculation method, applying a more simplified calculation methodology.</li> <li>b. In general, we believe that there will need to be an uplift in risk capital modelling capability within RSE(s) to enable the application of an RSE licensee-led risk exposure-based approach.</li> <li>c. We suggest that the methodology used for determining the baseline component amount using the RSE licensee-led methodology should take into account the following:               <ul style="list-style-type: none"> <li>i. Estimate of the costs to fund a recovery or exit activity</li> <li>ii. Fees chargeable to members less operating expenses to run the RSE over a reasonable period until the recovery or exit activity would be executed</li> <li>iii. Consideration of the overall reserves held by each RSE so as to prevent duplication of reserves which would only be used for mutually exclusive purposes, for example, RSE(s) planning for ‘exit/wind-up’ activities will unlikely be planning for future ‘risk mitigation’ activities on ongoing operations. Therefore, we suggest that the baseline component should be flexed downwards to take into account other reserves that would be redeployed into recovery or exit activities should these occur.</li> <li>iv. We also believe that the baseline component should be adjusted based on a probability of occurrence, given the narrow scope of its permitted usage which for a RSE with a very low probability of use, would result in an inefficient use of members’ funds.</li> </ul> </li> </ul>

	<p>5. What is the likely level of the baseline component?</p>	<p>a. This should depend on the size, risk, and business operations of RSE(s), and the estimated cost to activate plans under CPS230, CPS190 and CPS900.</p> <p>b. The Baseline component which requires the amount held to be “<i>maximum cost of implementing a trustee contingency or member transfer plan</i>”, may result in smaller RSE(s) holding more reserve than the current 25bps of FUM approach.</p> <p>c. For larger RSE’s that apply the RSE licensee-led method, we anticipate that the amount will be significantly lower than the amount that would be required under the basic calculation method as envisaged in the Discussion Paper.</p>
	<p>6. How often should the baseline amount be reviewed and why?</p>	<p>a. We believe that the baseline amount should be reviewed at least <u>annually</u>, or more when there is a material change to an RSE’s risk profile, business continuity plan, financial contingency plans or resolution plan</p>
	<p>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?</p>	<p>a. We believe it is appropriate to have an alternative calculation option on the baseline amount for RSE(s) that may not have sufficient capability, expertise or resource to calculate a risk-based baseline amount.</p> <p>b. For the basic calculation option, using an amount based on the number of members (cost per member) is a simplified approach, but may result in the need to hold a higher reserve than using an RSE licensee-led method. Therefore, the basic calculation option should not be seen as the minimum amount that all RSEs (regardless of methodology adopted) should hold as the Baseline component.</p>
	<p>8. Should APRA set a minimum amount for the baseline component or would this lead to unintended consequences?</p>	<p>a. We do not believe that a minimum amount should be set for the baseline component as this is unlikely to correlate to the risk profile of each RSE, meaning that:</p>

		<ul style="list-style-type: none"> <li>i. Where the minimum is <u>less</u> than the amount required for recovery or exit activities, RSE(s) may only hold the minimum amount which would not meet the objective to ensure that there are sufficient financial resources available for recovery or exit will not be met, or</li> <li>ii. Where the minimum is <u>more</u> than the amount required for recovery or exit activities, the amount held would be an inefficient use of members funds and not in members best financial interests</li> </ul>
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## APPENDIX 1 (continued)

Response to Discussion Paper questions raised by APRA's Discussion Paper (*Financial resources for risk events in superannuation, November 2022*), are detailed below:

Topic	Questions	Feedback response
<b>Operational risk component</b>	9. Would RSE licensees have the capability to determine an appropriate target amount for the operational risk component?	<ul style="list-style-type: none"> <li>a. Aware Super would have the capability to appropriately calculate the target amount for the operational risk framework. This would leverage the risk management framework to ensure that the Operational Risk Component appropriately reflects the risks within the RSE.</li> <li>b. However, we suggest that as per our response to question 2, should the enhancements as proposed in the Discussion Paper be implemented, it would lead to an increase in demand for risk-based capital modelling skills in the market more broadly</li> </ul>
	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)?	<ul style="list-style-type: none"> <li>a. The model(s) that determine both the Baseline component (assuming the RSE licensee-led methodology) and the Operational Risk component would need to include scenario analysis to be performed to ensure that they appropriately measure the potential outcomes for which they exist and the probabilities of each of these scenarios occurring. These should inform that appropriate target amount (and target range).</li> <li>b. The model(s) should also include clear identification of the triggers which could result in the reserve amounts needing to be increased or opportunities to decrease.</li> <li>c. We believe that the inputs, and alignment to the risk management framework should be reviewed at least annually, or more when there is a material change to an RSE's risk profile and be presented to the Audit, Risk and Compliance Committee and Board in line with the risk management framework.</li> </ul>



		<p>d. Furthermore, the model(s) would need to be subject to the controls that would be required for any complex financial model, including documentation, testing, internal review and sign-off, together with internal and external assurance as appropriate.</p>
	<p>11. How should a maximum timeframe for the replenishment of the operational risk component to its target amount be set?</p>	<p>a. Any replenishment to the target level (after falling below the tolerance limit) should be performed as early as possible on the provision that this would be equitable across member cohorts. We suggest that as a guideline, the timeframe be aligned to the timeline for the baseline component, ie a period of up to 3 years.</p> <p>b. Any replenishment plan should take into account factors such as potential recoveries from third parties, including insurance.</p>