

SHORT TOPIC PAPER THREE

Financial requirements, operational risk and outsourcing

Introduction

APRA is currently conducting a post-implementation review of the prudential framework for superannuation. As described in APRA's discussion paper released in May 2018, this is the third paper in a series of short topic papers covering six specific areas of the prudential framework.¹

This paper, as with the other papers, provides:

- the objectives and key requirements of the prudential and reporting standards (including guidance material) that fall within the relevant topic area;
- links to the final prudential and reporting standards; and
- a series of questions aimed at soliciting feedback on whether the prudential standards (including guidance material) and reporting standards have achieved their objectives and continue to remain fit for purpose.

The short topic papers seek to facilitate discussion and consideration of key elements of the prudential framework, and the provision of feedback from stakeholders that will:

- enable appropriate consideration of differing views on the effectiveness of the current prudential framework;

¹ APRA, *Post-implementation review of APRA's superannuation prudential framework*, 23 May 2018.

- provide a greater insight into the practical impact of the prudential framework;
- identify areas where improvements may be warranted;
- identify areas that could be streamlined to reduce compliance costs or improve outcomes; and
- ensure that full and appropriate consideration of the relevant areas and topics covered by the prudential and reporting standards is achieved.

APRA is undertaking this comprehensive post-implementation review to determine whether the prudential and reporting standards (and related guidance material) have achieved their objectives and remain fit for purpose. The review is not intended to revisit the original policy intent or objectives of the reforms, and is not seeking to either weaken or strengthen the prudential framework. Rather, APRA wishes to assess whether the prudential framework is operating effectively and efficiently, and to identify and seek to address any unintended consequences or areas for improvement in the framework.

Consultation on this and the other short topic papers will form part of APRA's industry engagement over the course of the review process, which will also comprise roundtables, small group discussions and bilateral meetings.

While formal written submissions close on 26 September 2018, written submissions (formal or informal) on any aspect of the review can be submitted at any time throughout the review process.

Financial requirements, operational risk and outsourcing

Scope

In the context of this review, the financial requirements, operational risk and outsourcing elements of the prudential framework cover:

- prudential standards – *Prudential Standard SPS 114 Operational Risk Financial Requirement* ([SPS 114](#)), *Prudential Standard SPS 231 Outsourcing* ([SPS 231](#)) and *Prudential Standard SPS 232 Business Continuity Management* ([SPS 232](#)) and their related guidance material which can be found on APRA's website.
- reporting standards – *Reporting Standard SRS 001.0 Profile and Structure (Baseline)* ([SRS 001.0](#)); *Reporting Standard SRS 114.0 Operational Risk Financial Requirement* ([SRS 114.0](#)); *Reporting Standard SRS 114.1 Operational Risk Financial Requirement* ([SRS 114.1](#)); *Reporting Standard SRS 320.0 Statement for Financial Position* ([SRS 320.0](#)); *Reporting Standard SRS 320.1 Statement of Financial Position* ([SRS 320.1](#)); *Reporting Standard SRS 330.0 Statement of Financial Performance* ([SRS 330.0](#)); *Reporting Standard SRS 330.1 Statement of Financial Performance* ([SRS 330.1](#)); *Reporting Standard SRS 330.2 Statement of Financial Performance* ([SRS 330.2](#)); *Reporting Standard SRS 331.0 Services* ([SRS 331.0](#)); *Reporting Standard SRS 540.0 Fees* ([SRS 540.0](#)); *Reporting Standard SRS 602.0 Wind-up* ([SRS 602.0](#)); *Reporting Standard SRS 703.0 Fees Disclosed* ([SRS 703.0](#)); *Reporting Standard SRS 711.0 SuperStream Benchmarking Measures* ([SRS 711.0](#)); and *Reporting Standard SRS 800.0 Financial Statements* ([SRS 800.0](#)).

Prudential Standards and Guidance

SPS 114 and its associated guidance material

Objectives and key requirements

The objective of SPS 114 is to ensure that registrable superannuation entity (RSE) licensees maintain adequate financial resources to address potential losses arising from operational risks that may affect RSEs within its business operations.

It is the responsibility of the board of an RSE licensee to ensure that it holds and has access to financial resources in the form of operational risk reserves, operational risk trustee capital or a combination of the two to meet the target amount of financial resources that the RSE licensee determines is necessary to respond to these potential losses.

The key requirements of SPS 114 are that an RSE licensee must:

- have a documented strategy that sets out the RSE licensee's approach to determining, implementing, managing and maintaining the Operational Risk Financial Requirement (ORFR) target amount;
- have suitable policies and procedures to manage the financial resources held to meet the ORFR target amount;
- determine a tolerance limit below the ORFR target amount that, if financial resources held to meet the ORFR target amount were to breach this limit, would require the RSE licensee to notify APRA and implement a replenishment plan; and

- ensure that the financial resources held to meet the ORFR target amount are only used to address an operational risk event or to ensure that the ORFR target amount remains at an appropriate level.

APRA has issued two prudential practice guides to assist RSE licensees in complying with the requirements in SPS 114, *Prudential Practice Guide SPG 114 Operational Risk Financial Requirement* (SPG 114) and *Prudential Practice Guide SPG 222 Management of Reserves* (SPG 222).

SPG 114 provides additional assistance to RSE licensees in complying with the ORFR requirements and outlines prudent practices in respect to the ORFR.

SPG 222 provides an RSE licensee with guidance in relation to the use, scope, size and operation of reserves.

SPS 231 and its associated guidance material

Objectives and key requirements

The objective of SPS 231 is to ensure that all outsourcing arrangements involving material business activities entered into by an RSE licensee are subject to appropriate due diligence, approval and ongoing monitoring.

It is the responsibility of the board of an RSE license to ensure that all risks arising from outsourcing material business activities are appropriately managed to ensure that the RSE licensee is able to meet its obligations to its beneficiaries.

The key requirements of SPS 231 are that an RSE licensee must:

- have a policy, approved by the board, relating to outsourcing of material business activities;
- have sufficient monitoring processes in place to manage the outsourcing of material business activities;
- have a legally binding agreement in place for all outsourcing of material business activities;
- consult with APRA prior to entering into agreements to outsource material business activities to service providers that conduct their activities outside Australia; and
- notify APRA after entering into agreements to outsource material business activities.

APRA has issued *Prudential Practice Guide SPG 231 Outsourcing* (SPG 231) and an information paper on shared computer service outsourcing to assist RSE licensees in complying with the requirements in SPS 231.

SPG 231 outlines a number of factors that an RSE licensee should take into consideration when entering into outsourcing arrangements and additional guidance on key considerations, particularly in relation to custody arrangements, offshoring and subcontracting.

SPS 232 and its associated guidance material

Objectives and key requirements

The objective of SPS 232 is to ensure that each RSE licensee has a whole-of-business approach to business continuity management (BCM) that is appropriate to the size, business mix and complexity of its business operations. BCM increases resilience to business disruption arising from internal and external events and may reduce the impact on the RSE licensee's business operations; it is a responsibility of the RSE licensee board.

The key requirements of SPS 232 are that an RSE licensee must:

- identify, assess and manage potential business continuity risks to ensure that it is able to meet its obligations to beneficiaries and protect the financial position of the RSE licensee, any of its RSEs or connected entities;
- consider business continuity risks and controls as part of its overall risk management framework and approve a BCM Policy;
- develop and maintain a business continuity plan that documents procedures and information which enable the RSE licensee to manage business disruptions;
- review the business continuity plan annually and periodically arrange for its review by the internal audit function or an appropriate external expert; and
- notify APRA in the event of certain disruptions.

APRA has issued *Prudential Practice Guide SPG 232 Business Continuity Management* (SPG 232) to assist RSE licensees in complying with the requirements in SPS 232. SPG 232 provides an RSE licensee with guidance on prudent practices that should be undertaken in relation to BCM. In particular, SPG 232 provides insight on key elements of BCM such as the business impact analysis and business continuity planning.

Prudential Standard and Prudential Practice Guide Questions

Questions

- 1) What outcomes have resulted from the implementation of the prudential standards and are these outcomes in line with their objectives?
- 2) Have the requirements in the prudential standards been embedded in RSE licensees' decision-making processes and practices?
- 3) Have the prudential standards achieved their stated objectives? If so, do they continue to remain fit for purpose given developments within the industry?
- 4) Have the prudential practice guides achieved their stated objectives? If so, do they continue to remain fit for purpose given developments within the industry?
- 5) Do the prudential standards, when read in conjunction with their relevant prudential practice guides, provide sufficient:
 - a) Clarity and certainty for RSE licensees in relation to their obligations as trustees of superannuation entities?
 - b) Flexibility for RSE licensees to achieve the objectives in a manner best suited to their business?

- 6) Are any of the requirements or principles contained in the prudential standards or prudential practice guides no longer applicable? Why?
- 7) Are there any aspects of the prudential standards or prudential practice guides that could be improved to:
 - a) Achieve better risk management outcomes?
 - b) Reduce compliance costs?
 - c) Facilitate better supervision by APRA?
- 8) Are there any additional areas that should be addressed?
- 9) What are the ongoing compliance costs associated with the prudential standards and their related prudential practice guides?

Reporting Standards

The following reporting standards relate to ORFR and other broader financial matters, including fees and costs, at both RSE and RSE licensee levels. The reporting standards can be used by APRA for its prudential supervision and publication purposes, and provide benefits for other interested stakeholders.

SRS 001.0

Objective and key requirements

The objective of SRS 001.0 is to capture baseline information relating to the profile and structure of RSE licensees and each RSE within its business operations.

The information required to be reported under SRS 001.0 includes:

- RSE licensee information including ownership, profit status and board structure;
- membership base information;
- defined benefit RSE information;
- MySuper product information; and
- select investment options information.

SRS 114.0

Objective and key requirements

The objective of SRS 114.0 is capture data on an RSE licensee's operational risk financial requirement.

The information required to be reported under SRS 114.0 includes:

- the way in which the ORFR is held;
- information on the ORFR target amount, ORFR reserves, ORFR trustee capital and ORFR tolerance limit;
- transition and replenishment plans if in force;
- payment details made to address an operational risk event; and

- movements of ORFR trustee capital.

SRS 114.1

Objective and key requirements

The objective of SRS 114.1 is to capture data on the operational risk reserve of an RSE licensee in respect to each RSE, defined benefit RSE, pooled superannuation trust (PST) and eligible rollover fund (ERF) within its business operations.

The information required to be reported under SRS 114.1 includes:

- the way in which the ORFR is held;
- information on the ORFR target amount, ORFR reserves and ORFR trustee capital; and
- movements of ORFR reserves (into, out and total).

SRS 320.0

Objective and key requirements

The objective of SRS 320.0 is to capture data on the financial position of RSEs, defined benefit RSEs, PSTs and ERFs.

The information required to be reported under SRS 320.0 includes:

- assets covering total receivables, investments, securities, derivatives, current tax assets, deferred tax assets, goodwill, reinsurance assets, property plant and equipment and other assets;
- liabilities covering payables, borrowings, derivative liabilities, securities, current tax liabilities, deferred tax liabilities, insurance liabilities and other liabilities; and
- member benefits including reserves.

SRS 320.1

Objective and key requirements

The objective of SRS 320.1 is to capture data on the financial position of defined benefit sub-funds.

The information required to be reported under SRS 320.1 includes:

- total assets and liabilities;
- net assets available for member's benefits;
- total reserves;
- total liability for members' benefits; and
- surplus/deficit in net assets.

SRS 330.0

Objective and key requirements

The objective of SRS 330.0 is to capture data on the financial performance of RSEs.

The information required to be reported under SRS 330.0 includes:

- member benefit flows in employer contributions, member contributions, defined benefit contributions, rollovers and successor funds transfers;
- member benefit outflows via benefit payments, rollovers, successor funds transfers, repatriation to employer sponsor, payments to unit holders and other member benefits outflows;
- investment income, gains/losses on investments and other investment income;
- operating income;
- investment expenses;
- administration and operating expenses;
- advice expenses; and
- insurance related inflows and outflows.

SRS 330.1

Objective and key requirements

The objective of SRS 330.1 is to capture data on the financial performance of sub-funds.

The information required to be reported under SRS 330.1 includes:

- member benefit flows in employer contributions, member contributions and defined benefit contributions;
- member benefit outflows via benefit payments, and repatriation to employer sponsor;
- investment income, gains/losses on investments and other investment income;
- operating income;
- investment expenses;
- administration and operating expenses;
- advice expenses; and
- insurance related inflows and outflows.

SRS 330.2

Objective and key requirements

The objective of SRS 330.2 is to capture data on the financial performance of a MySuper product, which can be used by APRA for its prudential supervision and publication purposes, and provide benefits for other interested stakeholders.

The information required to be reported under SRS 330.2 includes:

- member benefit flows in employer contributions, member contributions and accrued default amounts;
- member benefit outflows via benefit payments;
- investment income, gains/losses on investments;
- operating income;
- investment expenses;
- administration and operating expenses;
- advice expenses; and
- insurance related inflows and outflows.

SRS 331.0

Objective and key requirements

The objective of SRS 331.0 is capture data on the services provided to RSEs.

The information required to be reported under SRS 331.0 includes details of services where the RSE licensee is the service provider, services provided by external service providers, and income/expense transactions with associates.

SRS 540.0

Objective and key requirements

The objective of SRS 540.0 is to capture data on the fees charged in relation to an RSE or MySuper product.

The information required to be reported under SRS 540.0 includes:

- fees paid including administration, advice, exit, insurance, investment, switching and other fees;
- fee rebates and discounts; and
- activity fees including rebates and discounts.

SRS 602.0

Objective and key requirements

The objective of SRS 602.0 is to capture data relating to the winding up of an RSE.

The information required to be reported under SRS 602.0 includes:

- date of wind-up;
- method of wind-up; and
- details of receiving fund.

Additional data is also required to be captured through other reporting forms at the wind-up date in accordance with Attachment A to SRS 602.0.

SRS 703.0

Objective and key requirements

The objective of SRS 703.0 is to capture data on the fees and costs required to be disclosed in product disclosure statements relating to MySuper products. ASIC may also use the data collected under SRS 703.0.

The information required to be reported under SRS 703.0 includes:

- fees disclosed including administration, advice, exit, insurance, investment, switching and other fees;
- indirect costs ratio;
- administration fee levels disclosed;
- investment fee levels disclosure for lifecycle MySuper products;
- activity fees disclosed; and
- insurance premiums disclosed.

SRS 711.0

Objective and key requirements

The objective of SRS 711.0 is to capture data on the contribution transactions of RSEs. The information required to be reported under SRS 711.0 includes contribution processing including contribution transactions from active employers and the total cost of processing contributions transactions from active employers. SRS 711.0 is also used to monitor the changes in transaction costs arising from the introduction of SuperStream initiatives.

SRS 800.0

Objective and key requirements

The objective of SRS 800.0 is to capture data on the financial position of small APRA funds and single member approved deposit funds.

The information required to be reported under SRS 800.0 includes:

- total assets and liabilities;
- total reserves;
- total liability for members benefits;
- fund balance for levies;
- members' benefits outflows; and
- superannuation and insurance activities.

Reporting Standard Questions

Questions

- 1) Are the objectives of the reporting standards and reported information well understood?
- 2) Do the current reporting requirements in the reporting standards capture:
 - a) All relevant data relating to the operational risk financial requirement (ORFR) and other broader financial matters, including fees and costs?
 - b) Sufficient data to enable appropriate analysis of RSE licensees?
 - c) Data at an appropriate level of granularity?
- 3) Is the information captured under the reporting standards accurate, relevant and useful for policymakers, regulators, RSE licensees and the community?
- 4) What are the ongoing compliance costs associated with the collection of data required under the reporting standards?
- 5) Are there any aspects of the reporting standards that could be improved to:
 - a) Reduce ongoing compliance costs?
 - b) Improve the usefulness of the reported data?
 - c) Improve the accuracy of the reported data or clarity of definitions and other instructions?
 - d) Facilitate better supervision by APRA?
- 6) Are any of the current requirements in the reporting standards no longer applicable? Why?