



# AIST submission

**Response to APRA: Prudential Standards  
for Superannuation – April 2012**

**July 2012**



Australian Institute of Superannuation Trustees

## AIST

The Australian Institute of Superannuation Trustees (AIST) is an independent, not-for-profit professional body whose mission is to protect the interests of Australia's \$450 billion not-for-profit superannuation sector. AIST's members are the trustee directors and staff of industry, corporate and public-sector superannuation funds, who manage the superannuation accounts of two-thirds of the Australian workforce.

AIST is a registered training organisation and has recently expanded its education program to encompass the growing and changing needs of all members of the not-for-profit superannuation sector.

AIST offers a range of services including compliance and consulting services, events - both national and international - as well as member support. AIST also advocates on behalf of its members to relevant stakeholders.

AIST's services are designed to support members in their endeavour to improve the superannuation system and build a better retirement for all Australians.

## Contact

Fiona Reynolds, CEO

03 8677 3800

Eva Scheerlinck, Trustee Governance and Professional Standards Manager

03 8677 3800

## 1 Executive summary

AIST supports the intent of the prudential standards as drafted with some minor recommendations to clarify and improve certainty for trustees. Accordingly, this submission only addresses the areas where we believe that the standards would benefit from further guidance material or substantive change in some areas.

A number of recommendations appear several times throughout our submission, however we thought it prudent to reference them against each of the proposed standards. These relate to APRA requiring external expert assessments and the corporate group policies and functions.

The table below is a summary of our recommendations.

Prudential Standard	Recommendations	Prudential Guidance recommendations
SPS 510 Governance	<ul style="list-style-type: none"> <li>Non-directors should be allowed to be committee members and chairs of committees</li> <li>Corporate group policies and functions provision should be tightened</li> </ul>	<ul style="list-style-type: none"> <li>Skill requirements should not be a barrier to entry for new directors</li> <li>Clarification around the need for auditors to attend all audit meetings</li> </ul>
SPS 521 Conflicts of Interest	<ul style="list-style-type: none"> <li>The interests and duties should be 'relevant'</li> <li>Corporate group policies and functions provision should be tightened</li> </ul>	N/A
SPS 520 Fit and Proper	<ul style="list-style-type: none"> <li>Support</li> </ul>	<ul style="list-style-type: none"> <li>Guidance on APRA responsible person determination</li> <li>Guidance on overseas convictions</li> </ul>
SPS 220 Risk Management	<ul style="list-style-type: none"> <li>No prescription on the appropriate duration of the business plan</li> <li>Corporate group policies and functions provision should be tightened</li> </ul>	<ul style="list-style-type: none"> <li>Guidance on risk appetite</li> </ul>
SPS 231 Outsourcing	<ul style="list-style-type: none"> <li>External expert assessments should be reasonable</li> </ul>	N/A
SPS 530 Investment Governance	<ul style="list-style-type: none"> <li>Corporate group policies and functions provision should be tightened</li> </ul>	<ul style="list-style-type: none"> <li>Guidance on 'reasonable expectations of beneficiaries'</li> <li>Guidance on liquidity and sale of assets</li> </ul>
SPS 114 Operational	<ul style="list-style-type: none"> <li>Reserves held as capital to be subject to greater controls</li> </ul>	<ul style="list-style-type: none"> <li>guidance on allowable tolerance limits</li> </ul>

Risk Financial Requirement	<ul style="list-style-type: none"> <li>Clarify permitted to maintain other reserves</li> </ul>	<ul style="list-style-type: none"> <li>Provide guidance on using reserve</li> <li>Provide guidance of allowable alternate (to asset-based) models</li> </ul>
SPS 160 DB Benefit Matters	<ul style="list-style-type: none"> <li>Clarify allowable flexibility in funding to vested benefit level</li> <li>Extend maximum allowable restoration plan to 5 years</li> </ul>	<ul style="list-style-type: none"> <li>Provide guidance on interim actuarial investigations</li> </ul>
SPS 310 Audit and Related Matters	<ul style="list-style-type: none"> <li>External expert assessments should be reasonable</li> </ul>	N/A
SPS 232 Business Continuity Management	<ul style="list-style-type: none"> <li>External expert assessments should be reasonable</li> </ul>	N/A
SPS 250 Insurance in Superannuation	<ul style="list-style-type: none"> <li>Corporate group policies and functions provision should be tightened</li> <li>Relationships with insurers to be clarified</li> <li>Self insurance open to large APRA funds</li> </ul>	N/A

AIST notes the transitional requirements, particularly in relation to outsourcing arrangements, business continuity management and insurance contracts. During this significant period of change in the superannuation industry (not just with the introduction of prudential standards) we submit that APRA work closely with funds during the transition phase as well as extend a grace period for unintentional non-compliance.

---

## 2 Body of submission

---

### 2.1 SPS 510 – Governance

AIST supports the intent of the proposed governance standard and supports the requirements whereby RSE licensees should maintain governance arrangements appropriate to their size, business mix and complexity. Similarly, AIST supports appropriate flexibility in SPS 510 to allow for the differences that exist between superannuation funds where governance arrangements are concerned.

#### 2.1.1 Skills

AIST supports the need for boards to have a full range of skills as set out in paragraph 10 of SPS 510, but recommends that guidance be provided to clarify this requirement in relation to new trustee directors joining a board. A trustee development plan involving a minimum of 40 hours training should be provided to all incoming directors.

#### 2.1.2 Committees

Paragraph 11 of SPS 510 requires that only directors of the RSE licensee hold positions of chair of the following committees:

- *those that have responsibility for activities related to protecting the interests of beneficiaries, or*
- *meeting the reasonable expectations of beneficiaries, or*
- *the long term financial soundness of the RSE licensee, any of its RSEs or connected entities.*

This requirement is inflexible and may not be in the best interests of beneficiaries. AIST acknowledges the need for director accountability with regard to committees of the board. We understand that it is the current practice of some funds to have external non-directors engaged as committee chairs in specialist areas, for example investment and audit. While AIST recognises that APRA may be aware of particular instances where this arrangement has not been in the members' best interests, the new standards and trustee director obligations will result in these external chairs becoming responsible persons, subject to the new individual fit and proper requirements, and trustees becoming more accountable for the RSE licensee's business operations. AIST submits that there are sufficient protections in place through the combination of new standards and new obligations on trustees and individual directors to address any concerns that APRA may have in this area.

Similarly, AIST recognises APRA's preference to have the remuneration and audit committees comprised only of non-executive directors, making this a requirement in SPS 510 under paragraphs 34 and 43. We know however that some funds currently engage non-directors as chairs or committee members of these committees. Provided these arrangements are working well, AIST submits that such arrangements should be allowed with appropriate delegations and accountabilities in place, especially with the protections offered by the new legislative and regulatory regime.

Paragraph 52 of the standard requires auditors and/or actuaries to be invited to audit committee meetings. AIST suggests that this is not always necessary, and comes at great expense to the fund. AIST recommends some guidance around this requirement to give trustees greater clarity and certainly about what is required.

## 2.1.3 Remuneration policy

AIST welcomes the inclusion in paragraph 21 of the standard requiring the remuneration policy to include all forms of remuneration *'regardless of where, or from whom, the remuneration is sourced'*. AIST believes this will improve transparency in the industry.

## 2.1.4 Corporate groups

Paragraph 16 of SPS 510, like in some of the other standards, allows for RSE licensees who are part of a corporate group, to approve the use of policies and functions of the group, ensuring those policies and functions *'give appropriate regard to'* the business operations of the RSE licensee and its specific requirements.

We strongly recommend that this paragraph be amended to strengthen this obligation on the boards of RSE licensees that are part of corporate groups. The board of the RSE licensee must be required to discharge its fiduciary duties, not just *'give appropriate regard to'* the policies and functions of another body in the group. In addition to what might be appropriate for the corporate parent, the board renewal policy, as well as the internal audit function, for example, needs to comply with the requirements specifically set out in the standard.

## 2.2 SPS 521 – Conflicts of Interest

AIST supports the requirement that all RSE licensees develop and maintain a conflicts management framework comprising a comprehensive system of internal controls and reporting as well as a comprehensive conflicts policy. Directors' relevant interests and gifts should be declared and all external duties should be well known to the board and senior management. AIST agrees that all relevant conflicts of interest and duty should be registered.

RSE licensees are required under SPS 521 to publicly disclose their register of relevant duties and register of *'relevant'* interests. However, paragraph 14 of the standard requires RSE licensees to determine a dollar amount above which an interest will be deemed as *'material'*. AIST submits that while all interests determined to be *'material'* are therefore *'relevant'*, there should be consistency in the language used so that there is certainty and clarity for trustees. AIST prefers the use of the word *'relevant'*, particularly in a disclosure context.

### 2.2.1 Corporate groups

Paragraph 12 of SPS 521 allows for RSE licensees who are part of a corporate group, to approve the use of policies and functions of the group, ensuring those policies and functions *'give appropriate regard to'* the business operations of the RSE licensee and its specific requirements. We strongly recommend that this paragraph be amended to strengthen this obligation on the boards of RSE licensees that are part of corporate groups. The board of the RSE licensee must be required to discharge its fiduciary duties, not just *'give appropriate regard to'* the policies and functions of another body in the group, particularly where the policy concerned deals with conflicts of interest and duty.

## 2.3 SPS 520 – Fit and Proper

AIST supports the creation and maintenance of a fit and proper policy, as well as documented processes for assessing and taking action on fit and proper requirements for responsible officers.

Paragraph 12 of SPS 520 allows APRA to make responsible person determinations. AIST recommends guidance for trustees on the circumstances where APRA may be inclined to determine who is a responsible person of a RSE licensee.

Paragraph 50 of SPS 520 requires RSE licensees to be satisfied that responsible persons have not been convicted of any offence of dishonesty, even overseas. AIST submits that guidance should be provided to indicate to trustees what APRA will consider to be reasonable steps in furtherance of this requirement.

## 2.4 SPS 220 – Risk Management

AIST supports the requirement for RSE licensees to have a risk management framework that covers material risks to the business operations as a whole. AIST also supports the inclusion of items listed in the standard at paragraphs 11 (a) – (g) and 15 (a) – (f) in the risk management framework.

### 2.4.1 Risk appetite

Risk appetite is a new concept for the superannuation industry despite its existence in other APRA regulated industries. Guidance on the articulation of risk appetite would therefore be welcomed. Trustees would value some clarity and increased certainty on what is meant by risk appetite and how it might be expressed in a superannuation context.

### 2.4.2 Business plan

AIST supports the need for a business plan; however we submit that the requirement in paragraph 18 of SPS 220 is too prescriptive. Trustees, taking into account the size, business mix and complexity of their business operations may determine that a four or five year rolling plan is appropriate for their needs, rather than a three-year plan.

### 2.4.3 Risk management function

AIST supports the requirement for a ‘designated’ risk management function as opposed to a ‘dedicated’ risk management function. However, AIST has concerns with the requirements set out in section 24(d). Due to the prevalence of outsourcing in the superannuation industry, it is unlikely that the designated risk management function will have access to all aspects of the technology systems, for example, but rather, contractual overview.

### 2.4.4 Corporate groups

AIST supports the requirement for a designated risk management framework with flexibility to suit the size, business mix and complexity of the fund. AIST does not however support the paragraphs 8 and 25 requirements in relation to corporate group risk management functions and policies. We strongly recommend that these paragraphs be amended to strengthen the obligation on the boards of RSE licensees that are part of corporate groups. The board of the RSE licensee must discharge its fiduciary duties, not just ‘give appropriate regard to’ the policies and functions of another body in the group, particularly where it concerns risks to the trustee entity and its beneficiaries. The RSE licensee should have to attest to having

primary responsibility for the consequences of a failure of the function, not just reliance on another entity in the group for this responsibility.

## 2.5 SPS 231 – Outsourcing

AIST supports the intent of SPS 231 which will strengthen the current requirements and make outsourced arrangements more transparent.

### 2.5.1 External expert assessment

AIST seeks a reasonableness test in relation to the external expert or auditor assessment that APRA may require as set out in paragraph 33 of SPS 231. AIST supports the ability of APRA to require an external expert assessment, at the expense of the RSE licensee, provided the requirement is reasonable in all the circumstances and recommends that the following wording, from SPS 160 be adopted:

*‘if APRA considers, on reasonable grounds, that to do so would be in the best interests of beneficiaries.’*  
(paragraph 15)

## 2.6 SPS 530 – Investment Governance

AIST recognises that the proposed new legislative provisions in Parts 2C and 6 of the SIS Act stipulate the obligations regarding fees, costs and timely and independent valuation requirements. AIST welcomes further guidance by APRA once the legislative provisions become law.

Similarly, AIST recommends that APRA provide guidance in relation to the requirement further to SPS 530’s paragraph 7, whereby RSE licensees must have an investment governance framework to *‘meet the reasonable expectations of beneficiaries’*.

### 2.6.1 Investment objectives

AIST supports the requirement for the RSE licensee to set investment objectives that are specific and measurable, including both a return and risk objective. AIST, in particular, supports the lack of prescription attached to this requirement allowing for the individual nature of the RSE licensee and the option to use another measure other than the Standard Risk Measure first suggested in the September 2011 Discussion Paper. AIST submits that the Standard Risk Measure is a volatility measure only and that a better measure of risk could be developed.

### 2.6.2 Investment strategy and diversification

The new investment covenants proposed in section 52(6) of the SIS Act set out the expectations regarding diversification across the investment strategy for the whole of the entity as well as for each investment option. Paragraphs 16 and 19 of SPS 530 support the proposed legislative provisions and we endorse the standard as drafted.

### 2.6.3 Liquidity management

Further to our December 2011 submission, AIST again submits that SPS 530 should avoid liquidity management formulations that would artificially and unnecessarily require trustees to sell assets to meet liquidity requirements, especially if the sale is not otherwise in the best interests of members. Paragraph 29(e) states that an RSE licensee must have a liquidity management plan, approved by the board, for each

RSE within its business operations that, at a minimum outlines what action the RSE will take when a liquidity event occurs. AIST submits that guidance should be provided in relation to the sale of assets to comply with liquidity requirements under the standard, to avoid practices that are not in the best interests of beneficiaries.

## **2.6.4 Corporate groups**

Paragraph 6 of SPS 530 allows for RSE licensees who are part of a corporate group, to approve the use of policies and functions of the group, ensuring those policies and functions 'give appropriate regard to' the business operations of the RSE licensee. We strongly recommend that this paragraph be amended to strengthen this obligation on the boards of RSE licensees that are part of corporate groups. The board of the RSE licensee must discharge its fiduciary duties, not just 'give appropriate regard to' the policies and functions of another body in the group.

## **2.7 SPS 114 – Operational Risk Financial Requirement (ORFR)**

Overall, AIST welcomes the ORFR and the developments introduced since the September 2011 Discussion Paper, especially the provision for additional risks and the tolerance limit. However, there are a number of areas where AIST has identified the need for greater clarity, which would assist the smooth implementation and operation of this standard.

### **2.7.1 Definition of operational risks**

SPS 114 adopts the Basel Committee's definition of operational risk. Notwithstanding this, AIST hopes that APRA will be able to continue exploring a standardised approach to operational risk that is less complex and more appropriate to the Australian superannuation sector.

This definition is also used by APRA in its Probability and Impact Rating System (PAIRS). There may be nonetheless nuanced differences between the definitions. For example, the PAIRS definition of operational risk explicitly excludes costs to implement changes in response to legislative or industry developments. These costs can arise from inadequate or failed internal processes, and so appear to be included within the purpose for which the ORFR can be used unless specifically excluded.

### **2.7.2 Identified and non-identified operational risks**

AIST welcomes the flexibility provided by paragraph 6(b) of SPS 114 to allow the ORFR to be used for losses arising from 'unknown' and not specifically identified risks. While acknowledging that this does not in any way reduce the responsibility of a trustee to properly identify and plan for risk, this flexibility provides a measure of additional protection for members who have to ultimately bear the consequences of any loss.

The *APRA Response to Submissions* document suggests (8.2.3) that broadening the ORFR may lead to higher target levels being appropriate. However, 8.2.1 repeats APRA's earlier expectation of a 'normal' minimum reserve of 25 basis points. Accordingly, further clarification would be welcome.

After the standard is in operation for a reasonable period, it is likely that the extent and nature of hitherto unidentified operational risks will become clearer. AIST submits that APRA should progressively update its guidance material to accommodate this, not just for the purpose of the ORFR, but also to assist trustees in the ongoing development of their risk management plans.

## 2.7.3 Tolerance limit

AIST supports the concept of the tolerance limit that has been introduced in the standard. This means that the ORFR does not have to be maintained at a particular level, but may rise above and fall below the target reserve. This may be a consequence of investment market rises and falls.

It is unclear however what this means in the consequence of paragraphs 27 and 31 of SPS 114. Does this mean that a trustee has to reach the target reserve within three years of 1 July 2013, or (alternatively) mean that a trustee is required only to have the reserve meet an amount within the tolerance within that time? If it is the latter, presumably, once the deadline hits, the amount in the reserve can fall to a level below the target, but still be above the tolerance limit. If it is the former, does the trustee also have to notify APRA when the target reserve is met for the first time, regardless of the time that has elapsed since the fund reached the tolerance limit? Trustees would welcome APRA guidance on these questions.

With asset allocation targets, trustees may have target levels and both soft and hard ranges. The soft ranges generally operate as a trigger for increased monitoring or action, while care is taken to ensure that hard ranges are not breached. A similar approach may be useful in relation to the ORFR, and APRA guidance on these matters would be appreciated by trustees.

These questions also impact on the management of an ORFR shortfall set out in paragraphs 17(g) and 18 of SPS 114. Presumably, the minimum requirement of a replenishment plan should be to have the fund get above the tolerance limit, with comfort also given to APRA that steps will then be taken to get the fund within the soft range and to take further steps toward the target level. AIST recommends clarification on this issue.

AIST supports the flexibility that is provided in the standard for a replenishment plan to be 'within a reasonable period' and 'fair with regard to the beneficiaries'. This will enable trustees to properly have regard to market circumstances and other factors impacting upon the fund in implementing a replenishment plan. AIST submits however, that APRA provide further guidance on its normal expectations for tolerance limits, and suggests a normal limit of 20 basis points – or 20% less than the normal target - below which the ORFR is not permitted to fall.

## 2.7.4 Composition of the ORFR

AIST notes that the ORFR must be held either as a reserve with the fund or as capital by the trustee. The standard is, however, silent about any limitations or special requirements if the ORFR is sourced, built up or replenished by a party external to the fund or trustee. This could include the trustee's parent company, shareholders, or other parties. The implication of SPS 114 is that the ORFR will be built up from within its own resources, as it indeed will be in most cases.

However, the standard should make it clear that capital provided to a trustee cannot be a loan or provided on any terms that creates any obligation on the trustee whatsoever. Such prohibited terms could include a requirement to repay the capital, or caveats upon its use. It should be made clear that these financial resources are reserves and not held as some form of capital or a provision. That is, the amount is to specifically address unexpected contingencies and able to be used without delay or argument in the event of a material operational risk event occurring.

## 2.7.5 Relationship with other reserves

The ORFR is just one of the reserves that a trustee may maintain. Other possible reserves include administration reserves and investment reserves. Different reserves may be separate or inter-related with each other, including the ORFR.

Each type of reserve may be a legitimate part of a trustee's prudential management of the fund. However, members of the fund are entitled to a clear statement of the role and function of each reserve and the relationship between them.

Therefore, AIST recommends that the minimum elements of the ORFR strategy include 'the relationship between the ORFR and other reserves the trustee may hold, including the relationship between the way each reserve may be called upon and replenished'.

APRA's Response to Submissions notes that it received a submission on the relationship between reserves without further comment. AIST submits that APRA should also provide guidance to trustees that the ongoing maintenance of other reserves both to manage other risks and for other purposes is permissible and may be appropriate and desirable for funds to meet their obligations to members.

## 2.7.6 Notification requirement

AIST submits that the requirement in paragraph 25 of SPS 114 to notify APRA if a trustee becomes aware of a material emerging operational risk is too subjective, and reflects existing concerns with notifications which can see one trustee notify an event which another does not – with both acting on reasonable grounds.

At which point does a risk emerge? Is it the point at which the likely amount to address the risk passes a certain point? The standard should be clarified or guidance should be provided.

## 2.7.7 Using the ORFR

Just as the notification requirement set out in paragraph 25 of SPS 114 is underpinned by considerations of materiality, so should the strategy in relation to the use of the reserve. Unexpected events that have a financial impact on a fund occur on a regular basis, and are part and parcel of the operational management of any business. For the most part these matters are minor, and many budgets include contingency provisions.

The reserve should not be used in the normal course of business. In particular, they should not be used to balance a budget when a relatively minor operational risk event occurs, and the reserve could be a handy source of funds. The ORFR should be reserved for significant operational risk events that would otherwise impact upon returns to members or otherwise adversely impact on members. AIST submits that this should be included in the guidance APRA intends to produce.

## 2.7.8 ORFR target amount

AIST supports the requirements for setting the ORFR as set out in SPS 114 and agrees that funds under management alone is not the most appropriate basis for calculating the ORFR; having regard to a fund's operational costs is also a relevant consideration. AIST recommends that guidance material should be published that identifies and comments upon the efficacy of different models so that the superannuation industry has a better sense of permissible models.

### 2.7.9 External expert assessment

In a similar vein to our submissions on some of the other standards in this paper, AIST seeks a reasonableness test in relation to the special purpose engagements that APRA may require as set out in paragraph 24 of SPS 114. AIST supports the ability of APRA to require an external expert to provide a special report, at the expense of the RSE licensee, provided the requirement is reasonable in all the circumstances and recommends that the following wording, from SPS 160 be adopted:

*'if APRA considers, on reasonable grounds, that to do so would be in the best interests of beneficiaries.'*  
(paragraph 15)

### 2.7.10 Corporate groups

Paragraph 11 of SPS 114 allows for RSE licensees who are part of a corporate group, to approve the use of policies and functions of the group, ensuring those policies and functions *'give appropriate regard to'* the business operations of the RSE licensee. We strongly recommend that this paragraph be amended to strengthen this obligation on the boards of RSE licensees that are part of corporate groups so that the board must discharge its fiduciary duties, not just *'give appropriate regard to'* the policies and functions of another body in the group.

## 2.8 SPS 160 – Defined Benefit Matters

Defined benefit superannuation funds are quite different from other financial products and from other superannuation funds, even though defined benefit funds are often a hybrid of both defined benefit and accumulation interests. Defined benefit funds have more varied characteristics within their category of fund than other superannuation funds. As a consequence, we submit that SPS 160 probably requires more review than other standards.

Since 2008, a significant number of defined benefit funds have experienced a shortfall between the current valuation of their assets and funding to the vested benefit level. In many instances, this shortfall continues to exist, and so the transitional provisions of SPS 160 are especially important. The standard should be applied in a way that provides continuity and minimum reasonable disruption to the members of these funds.

The flexibility provided by SPS 160 is welcomed (e.g., the introduction of a shortfall limit). However, the standard still does not sufficiently differentiate between the different type and situation of defined benefit funds. There is a marked difference between the situation of corporate and public sector funds, between single and multi-employer funds, and between large and small funds. AIST does not believe that the consequences of these differences are fully reflected in SPS 160.

### 2.8.1 Funding to vested benefit level

AIST strongly supports the requirement of paragraph 29(b) of SPS 160 for a trustee to consult with employer-sponsors about implementing the recommendations of an actuary who has found the fund to be or likely to be in an unsatisfactory financial position. However, paragraph 9.2.2 of the Response to Submissions notes that the actuarial recommendations would normally be developed in consultation between the actuaries and employer sponsors. While this may occur, AIST supports the decision not to have this expectation included in SPS 160 as a requirement.

Consultation with employer-sponsors at or before the stage of the actuarial investigation is more likely to occur when the fund has one employer-sponsor. However, it may be more reasonable and practicable for this consultation to occur after actuarial recommendations have been received where a fund has multiple employer-sponsors.

The volatility of investment markets means that exact and continual funding to 100% of vested benefit levels is neither practical nor desirable and AIST recognises that this is reflected in the notion of a shortfall limit. AIST also submits that regulation of the system should also guard against the overfunding of defined benefit funds. Overfunding can cause resentment on the part of employer sponsors and often results in arguments about the treatment of the surplus funding.

Paragraph 29(d) of SPS 160 identifies the responsibility of an actuary during the period a fund is in an unsatisfactory financial position, including to give *'advice in regard to the determination of any reduction to the amounts of any benefit payments from the fund during the period'*. We note that a reduction could amount to a suspension of payments, a circumstance that could occur when an employer-sponsor is unwilling or unable to make additional contributions.

### 2.8.2 Shortfall limit

AIST supports the flexibility provided by a shortfall limit, and agrees that it is in the best interests of members covered by defined benefit funds.

AIST submits however that guidance will be useful for trustees to help them identify what will be permissible by way of shortfall limits. Will the limit be set by APRA or by an actuary under section 10 of SPS 160? An appropriate level might be, for example, close to the 95% funding currently expected by APRA.

### 2.8.3 Actuarial investigation

APRA maintains close control over the actuarial regulation of defined benefit funds. A fund appoints the actuary, but APRA:

- provides the direction for the investigation (paragraph 24),
- can terminate the actuary's appointment at any stage (paragraph 15),
- can override professional standards of the Actuaries Institute (paragraph 18),
- may get a copy of the actuarial report (paragraph 20) and;
- must be given any report finding an unsatisfactory financial position (paragraph 29(a)).

The power to terminate an actuary and override the professional standards of actuaries should be subject to a requirement for APRA to act 'on reasonable grounds'. For example, it may or may not be reasonable to terminate an actuary on the basis of APRA and the actuary making different actuarial assumptions (e.g., assumed long term investment returns), but the significance of this should be able to be tested on reasonableness grounds.

AIST also recommends that APRA provide defined benefit funds with guidance in relation to interim actuarial investigations. For example, what happens if a fund falls below the shortfall limit on a number of separate occasions within a short period? Is an interim investigation required in each case? This may occur during an extended period of high investment market volatility.

AIST supports the reasonableness test in relation to the external auditor investigation that APRA may require as set out in paragraph 15 of SPS 160. AIST supports the ability of APRA to require an external expert

assessment, at the expense of the RSE licensee, provided the requirement is reasonable in all the circumstances and recommends that the following wording, from SPS 160 be adopted:

*'if APRA considers, on reasonable grounds, that to do so would be in the best interests of beneficiaries.'*  
(paragraph 15)

AIST notes that an actuarial report as set out in paragraph 21(a) of SPS 160 should exclude any amount held by the RSE licensee to meet the ORFR. AIST does not support the ORFR being excluded.

#### **2.8.4 Plan duration**

AIST supports a longer maximum restoration period than the three years previously proposed and now reaffirmed by APRA in the Response to Submissions. Reduction of member benefits is not in a member's best interest if there is a reasonable prospect that their full entitlements can be funded within a longer period. A longer period for a restoration plan is feasible where the defined benefit fund has a larger cohort of employer sponsors (and therefore a smaller risk of going out of business) or employers that are government entities.

The differences between defined benefit funds as well the lack of control over future market conditions, means there is no ideal period of time for every defined benefit fund to be returned to a satisfactory financial position. The time frame could be four years for one fund, seven years for another or ten years in other cases. AIST submits that three years appears to be unrealistic particularly in the current economic climate. Accordingly, AIST supports the maximum length of time in paragraph 28(a)(ii) be increased to five years.

Paragraph 32(a) provides APRA with the power to lengthen a restoration plan period. However, this should be supported by guidance to a fund about the criteria that need to be met in order to gain a reasonable expectation that APRA will grant the extension.

#### **2.8.5 Transitional arrangements**

SPS 160 does not provide much clarity on the course APRA will follow when a fund is below the shortfall limit at the time the standard comes into effect. Paragraph 38 requires a restoration plan within six months of the effective date but this should be covered by further and specific requirements.

In particular, AIST recommends that paragraph 38 of SPS 160 be amended to provide that where a restoration plan approved by APRA is in effect at the effective date, the existing restoration plan is regarded as a restoration plan under SPS 160 and will continue in effect until its existing expiry date.

#### **2.8.6 Self-insurance**

AIST submits that there need not be a contingency plan about exiting from self-insurance arrangements as set out in paragraph 29(d) of SPS 160 where the other requirements of paragraph 33 are met.

#### **2.8.7 Corporate groups**

Paragraph 8 of SPS 160 allows for RSE licensees who are part of a corporate group, to approve the use of policies and functions of the group, ensuring those policies and functions 'give appropriate regard to' the business operations of the RSE licensee. We strongly recommend that this paragraph be amended to strengthen this obligation on the boards of RSE licensees that are part of corporate groups. The board of the

RSE licensee must discharge its fiduciary duties, not just ‘give appropriate regard to’ the policies and functions of another body in the group, particularly where solvency matters are concerned.

## 2.9 SPS 310 – Audit and Related Matters

AIST endorses the key requirements of SPS 310 in relation to the obligations and responsibilities of both RSE licensees and approved auditors.

### 2.9.1 External expert assessments

In a similar vein to our submissions on the other standards in this paper, AIST seeks a reasonableness test in relation to the special purpose engagements that APRA may require as set out in paragraph 26 of SPS 310. AIST supports the ability of APRA to require an auditor to provide a special report, at the expense of the RSE licensee, provided the requirement is reasonable in all the circumstances and recommends that the following wording, from SPS 160 be adopted:

*‘if APRA considers, on reasonable grounds, that to do so would be in the best interests of beneficiaries.’*  
(paragraph 15)

## 2.10 SPS 232 – Business Continuity Management

AIST supports the Business Continuity Management requirements set out in SPS 232 and acknowledges that the key requirements set out in the standard are common practice currently for most RSE licensees. We note that while a declaration by an outsourced service provider may be of assistance to an RSE licensee in forming a view on their ability to adequately respond in the event of a crisis, that such a declaration will not absolve the RSE licensee of its obligations. The obligations set out in the standard relating to the business continuity plans of outsourced service providers brings consideration of the potential risks to the fore and creates additional protections for the business operations of the RSE licensee.

### 2.10.1 External expert assessment

AIST seeks a reasonableness test in relation to the external expert assessment that APRA may require as set out in paragraph 30 of SPS 232. AIST supports the ability of APRA to require an external expert assessment, at the expense of the RSE licensee, provided the requirement is reasonable in all the circumstances and recommends that the following wording, from SPS 160 be adopted:

*‘if APRA considers, on reasonable grounds, that to do so would be in the best interests of beneficiaries.’*  
(paragraph 15)

## 2.11 SPS 250 – Insurance in Superannuation

AIST remains supportive of the intent of this standard and supports the requirement to formulate and give effect to an appropriate selection process for insurers. This will require a greater degree of rigour in the industry and will lead to greater transparency in this area.

AIST also supports the insurance benefits set out in paragraph 5 (a) and the apparent allowance of hybrid benefit constructions.

## 2.11.1 Corporate groups

Paragraph 6 of SPS 250 allows for RSE licensees who are part of a corporate group, to approve the use of policies and functions of the group, ensuring those policies and functions 'give appropriate regard to' the business operations of the RSE licensee and its specific requirements. We strongly recommend that this paragraph be amended to strengthen this obligation on the boards of RSE licensees that are part of corporate groups. The board of the RSE licensee must discharge its fiduciary duties, not just 'give appropriate regard to' the policies and functions of another body in the group.

Similarly, the requirement in paragraph 18 of the standard should be strengthened. Where a corporate group uses a related party insurer to retain profits within the group, AIST submits that they should be required to do more than conduct the relationship '*at arm's length*' and '*in the best interests of beneficiaries*'.

## 2.11.2 Due diligence

Paragraph 17(b) of SPS 250 requires due diligence to be carried out by the RSE licensee of its selected insurers. AIST submits that this should be tempered on the basis that insurers are also regulated entities obliged to meet a variety of legal and regulatory requirements including prudential standards. APRA guidance would be welcomed on what is considered a reasonable process in this regard.

## 2.11.3 Self insurance

AIST submits that self insurance should be available for DB funds, public sector funds and also large public offer funds who can demonstrate to APRA that they have the capacity to underwrite their insurance strategy while maintaining ongoing solvency and meeting the required reserving and other policies. The standard should reflect the possibility as funds grow, that self-insurance may be appropriate and in the best interests of beneficiaries.