



Prudential Guidance for Superannuation

AIST submission

March 2013



Australian Institute of Superannuation Trustees

AIST

The Australian Institute of Superannuation Trustees (AIST) is the peak representative body of Australia's \$500 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 almost two-thirds of the Australian workforce.

AIST plays a key role in policy development and advocates on behalf of its members to the Government and relevant stakeholders. We also offer a range of services including professional development, research, compliance, events (both national and international) and other consulting services as well as member support.

Contact

Tom Garcia, CEO

(03) 8677 3800

Eva Scheerlinck, Executive Manager Governance

(03) 8677 3814

1 Executive Summary

AIST appreciates the opportunity to make submissions concerning the draft prudential practice guides released by APRA for consultation on 11 December 2012.

AIST supports the intent of the prudential practice guides and this submission tries only to further clarify some of the concepts and guidance offered in the draft practice guides. In addition, this submission only deals with those prudential practice guides for which it has recommendations for improvement or where further clarification is required:

- SPG 220 Risk Management
- SPG 231 Outsourcing
- SPG 250 Insurance in Superannuation
- SPG 510 Governance
- SPG 520 Fit and Proper
- SPG 521 Conflicts of Interest
- SPG 530 Investment Strategy – Formulation
- SPG 531 Investment Strategy - Implementation

2 SPG 220 Risk Management

SPG 220 provides some guidance for RSE licensees on expressing a risk appetite statement, however, we submit that providing examples may assist superannuation funds to comply with the prudential standard requirements, at least in the first instance. While we accept that APRA does not want to set the standard or the form of risk appetite statements, but rather encourage individual RSE licensees to develop risk appetite statements that reflect the nature and complexity of their own risks, we submit that best practice examples would be of great assistance to the industry while it develops its competency for expressing risks in this way. We submit that risk appetite statements will evolve and improve over time, and any examples provided as part of guidance materials could be amended (or even removed from the materials) once these new requirements are embedded into RSE licensee processes.

At paragraph 25 of SPG 220 it is suggested that risk quantification techniques are not appropriate for all types of risk. AIST submits that the phrasing used in the first sentence of this paragraph does not make it clear that an RSE licensee needs to consider a variety of processes to measure risk, and that a measure that looks at quantity alone may not satisfy the regulator for the purposes of fulfilling risk management prudential requirements. We submit that this could be better explained.

In terms of the risk tolerance provisions in SPG 220, we recommend that the examples given at paragraph 32 be reviewed so that they flow more naturally from paragraph 31. At paragraph 31 it says “APRA expects that the RSE licensee would develop and implement a plan of action to review the risk and reduce it.” Two of the examples in paragraph 32, however have zero tolerance limits. AIST recommends that the examples might therefore work better where the risk tolerance level is set at a point where it can still act as a warning flag to trigger appropriate mitigating action by an RSE licensee.

The attachment provided with SPG 220 provides examples of what APRA considers to be material risks. AIST is conscious that the risks set out in Attachment A are not meant to be a comprehensive list and accordingly

recommends that the language be inclusive, rather than exhaustive. Paragraph 8 in the attachment, for example, says that “Insurance risk is the risk where an RSE licensee self-insures benefits to members.” We submit however that there are also other insurance risks, and accordingly that the language should be amended to “insurance risk includes the risk...” or “the risks arising from provision of insurance include...”.

3 SPG 231 Outsourcing

Outsourcing is prevalent in the superannuation industry and AIST recognises that this can create risks that must be appropriately managed. Outsourcing risk is a vital part of the risk management frameworks of Australia’s superannuation funds, while also forming an important component of business continuity planning.

Paragraph 1 of SPG 231 appears to suggest that the risk to the beneficiaries of the RSE should underpin the basis of prudential guidance on outsourcing. Paragraph 2 of SPG 231 states that “outsourcing refers to all arrangements with any other party to perform a business activity that is a function or responsibility of an RSE licensee”. AIST disagrees with the use of the phrase “or responsibility” in this context, as the risks associated with outsourcing functions are borne and managed by the trustee, acting in the best interests of the beneficiary. Responsibility of this nature cannot be outsourced by the RSE licensee.

Accordingly, AIST submits that paragraphs 1 and 2 of SPG 231 should be amended to reflect the true nature of outsourcing risk and responsibility, namely that the risks are borne by the trustee acting in the best interests of beneficiaries.

SPS 231 refers to arrangements “on a continuing basis” forming an outsourcing arrangement. This wording is not used in SPG 231 and we submit that to avoid confusion consistent wording should be used to define outsourcing across the two documents.

4 SPG 250 Insurance in Superannuation

SPG 250 offers appreciated guidance on the implementation of the insurance in superannuation prudential standard, SPS 250. AIST however makes the following observations:

At paragraph 22 the draft practice guide states “that a prudent RSE licensee would also maintain accurate and up-to-date records of claims that are continuing to be paid”. AIST submits that this paragraph should also make reference to claims as yet unresolved.

Paragraph 40(d) of SPG 250 includes “procedures for deducting premiums from beneficiaries’ accounts” as part of ‘insurance arrangements’. Insurance arrangements, as per paragraph 41, outline the responsibilities of the RSE licensee and the insurer’s service levels. Accordingly AIST respectfully submits that how premiums are deducted from beneficiaries’ accounts is not an appropriate requirement of an insurance arrangement, and any such reference belongs elsewhere in the practice guide.

Further at paragraph 41 APRA specifies that claims experience information be provided as part of the insurance arrangement. The trustee usually provides claims experience information when tendering the arrangement, and we therefore submit that its inclusion here is confusing.

5 SPG 510 Governance

Board composition is one of the areas of focus of this prudential practice guide. While APRA addresses the concept of independent and non-affiliated directors on RSE licensee boards, and the composition of board committees, it misses the opportunity to provide guidance on broader diversity issues. AIST submits that diversity of thinking is vital to a well-functioning board and recommends that diversity be a consideration when considering board appointments. One of the more easily identified areas of diversity is gender, and AIST recommends that APRA include in its guidance material to the superannuation industry a recommendation that gender representation on the board be considered and actioned.

With regard to the consideration of appointing independent or non-affiliated directors to superannuation boards, AIST is conscious that the section 10 definition in the *Superannuation Industry (Supervision) Act 1993* restricts APRA's guidance in this area. In fact the section 10 definition of independent director, which applies only to equal representation boards complicates the use of common terminology not only across all superannuation sectors, but across corporate boards generally. AIST will continue to advocate for change to the SIS Act definition so that this aspect of SPG 510 may become clearer, and can be amended in the future.

AIST restates its long-held view that any requirement to appoint an independent or non-affiliated director as chair of the board should be subject entirely to the needs of that particular RSE licensee, and we continue to object to any positive obligations on boards in this regard.

Similarly AIST reiterates its position that non-directors should be able to form part of board committees, where the board decides this is appropriate for that particular fund. Ultimately the board is responsible for the conduct and affairs of the RSE and having non-directors on any of the board committees does not change that fact. While we understand the rationale for having directors on board committees, and the desire to make committee members more accountable, we do not understand the need to have **all** committee members being directors on the Audit and Remuneration committees. AIST would like APRA to reconsider its position, and in the guidance material instead suggest that the majority of the committee members need to be directors of the RSE. Many AIST members who have deliberately sought the service of specialised non-directors on their committees presently attest to their high levels of skill and their additional insights that augment director members' views at committee meetings.

With regard to board renewal and equal representation board requirements, we submit that paragraphs 29 and 30 of SPG 510 do not accurately reflect the appointment processes available to equal representation boards or the requirements under the law. Paragraph 29 refers to potential representatives submitting nominations, whereas the trust deed and governing documents of the trustee will dictate how board appointments are made. Other than the fit and proper requirements, there may be no other avenues open to a trustee to determine whether an individual is appropriate to act as a director. Some directors are elected, while others for example may be appointed to the board by virtue of their position. For example, the trust deed might require that the person holding the role of president of a particular nominating organisation will be a director of the fund.

At paragraphs 22 and 23 of SPG 510 APRA sets out a list of possible board objectives against which the board's performance should be measured. The listed objectives extend at paragraph 23(c) to 'assessing senior management performance against agreed criteria' and then goes on to state explicitly an 'effectiveness of risk controls' criteria. This paragraph is confusing and should be amended to, at the very least, separate the two elements. The meaning of effectiveness of risk controls is also unclear.

6 SPG 520 Fit and Proper

AIST submits that further guidance could be offered in SPG 520 in relation to the fit and proper requirements of individuals from service providers to the RSE licensee who have been identified as responsible persons. For example, do RSE licensees need to assess all individuals of their internal audit teams (where this is a function performed by an external accounting firm), their external audit teams (also an external accounting firm) or their consulting actuarial team (an external actuarial firm)?

AIST submits that paragraph 43 should be amended so that it refers to SPS 520 as opposed to SPS 250.

7 SPG 521 Conflicts of Interest

SPG 521 requires an annual robust review of the conflicts management framework by a person who is operationally independent from those responsible for administering the framework. AIST submits that guidance from APRA would be useful on who it believes should conduct these reviews.

Also, further guidance would also be useful to clarify the conflict of duty parameters, particularly in relation to priorities and how that might play out in relation to an individual's appointment on a super fund board, and also the board of a service provider. Further clarification on the extent that these duties will override the duty of confidentiality would also be useful for the industry.

8 SPGs 530 and 531 Investment Strategy – Formulation & Implementation

AIST supports the intent of both SPG 530 and SPG 531 but points out the express absence of any stated mention of the long-term nature of superannuation investments. AIST believes that it is worthwhile reiterating the important long-term nature of superannuation in guidance material so that this focus is never lost by the industry.

AIST also submits that the guidance examples in relation to setting the return and risk objectives in SPG 530 could be strengthened to reflect the desired long-term focus of superannuation investments. By setting out examples with objectives specifying “x” and “y”, the substitutions could be read in a very short-term framework and we would recommend that some more specific time horizons be used as examples, or at least a long-term objective alongside other horizons that an RSE licensee might deem appropriate for its members.

With regard to the guidance offered for lifecycle investment strategies, AIST is concerned that there be sufficient flexibility to accommodate relevant factors other than age. AIST submits that paragraph 76 in SPG 530 be amended to reflect this, and that more detail be included in paragraph 79 to facilitate lifecycle strategy development. That is, that characteristics such as ethnicity, gender and occupation, for example, also be listed as possible relevant considerations.

In relation to the treatment of environmental, social and governance issues in SPG 530, AIST submits that more work is necessary to properly reflect the developing area of ESG considerations by institutional investors. In particular, paragraph 88 should be amended so that not only ‘ethical’ investment options are covered, but also any investment strategy that considers broader ESG factors, such as sustainable governance models as well as

sustainable social and environmental practices – all relevant considerations for the long-term success of investing in a particular asset.

9 Conclusion

Overall AIST supports the intent of the draft prudential practice guides and believes that the guidance offered will greatly assist RSE licensees to comply with the new prudential standards.

While some issues require further clarification, or could potentially benefit from the use of examples, the draft guides will be a useful tool for superannuation funds.

AIST would be pleased to provide further information, if required.