



Note: Faded text relates to pre-existing requirements that are not subject to consultation.

## Prudential Standard SPS 220

### Risk Management

#### Objectives and key requirements of this Prudential Standard

This Prudential Standard establishes requirements for an RSE licensee to have systems for identifying, assessing, managing, mitigating and monitoring material risks that may affect its ability to meet its obligations to beneficiaries. These systems, together with the structures, policies, processes and people supporting them, comprise an RSE licensee's risk management framework.

The Board of an RSE licensee is ultimately responsible for having a risk management framework that is appropriate to the size, business mix and complexity of the RSE licensee's business operations and that enables the RSE licensee to implement risk management approaches that appropriately manage different types of risk. The risk management framework must also be aligned with the RSE licensee's business plan.

The key requirements of this Prudential Standard are that an RSE licensee must:

- maintain a risk management framework that is appropriate to the size, business mix and complexity of its business operations, as relevant;
- maintain a Board-approved risk appetite statement;
- maintain a Board-approved risk management strategy that describes the key elements of the risk management framework that give effect to the approach to managing risk;
- maintain a Board-approved business plan that sets out the approach for the implementation of the strategic objectives of the RSE licensee's business operations;
- maintain adequate resources to ensure compliance with this Prudential Standard; and
- notify APRA when the RSE licensee becomes aware of a significant breach of, or material deviation from, the risk management framework, or discovers that the risk management framework does not adequately address a material risk.

**Authority**

1. This Prudential Standard is made under section 34C of the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

**Application**

2. This Prudential Standard applies to all registrable superannuation entity (RSE) licensees (RSE licensees) under the SIS Act.<sup>1</sup>
3. All RSE licensees must comply with this Prudential Standard in its entirety, unless otherwise expressly indicated.
4. This Prudential Standard commences on [1 January 2019].

**The role of the Board and senior management**

5. An RSE licensee must at all times have a risk management framework to appropriately manage the risks to its business operations.<sup>2</sup>
6. For the purposes of this Prudential Standard, the risk management framework is the totality of systems, structures, policies, processes and people within an RSE licensee's business operations that identify, assess, manage, mitigate and monitor all internal and external sources of inherent risk that could have a material impact on the RSE licensee's business operations or the interests of beneficiaries (material risks).<sup>3</sup>
7. The Board of the RSE licensee (the Board) is ultimately responsible for the risk management framework.<sup>4</sup>
8. The Board is ultimately responsible for maintaining the solvency of the RSE licensee and ensuring that the RSE licensee's business operations have adequate resources to undertake the activities for which it holds an RSE licence.

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<sup>1</sup> For the purposes of this Prudential Standard, 'RSE licensee' has the meaning given in section 10(1) of the SIS Act.

<sup>2</sup> For the purposes of this Prudential Standard, an 'RSE licensee's business operations' includes all activities as an RSE licensee (including the activities of each RSE of which it is the licensee), and all other activities of the RSE licensee to the extent that they are relevant to, or may impact on, its activities as an RSE licensee. The risk management framework must also cover risks that arise from functions that are outsourced; refer to *Prudential Standard SPS 231 Outsourcing* (SPS 231).

<sup>3</sup> For the purposes of this Prudential Standard, a reference to 'beneficiaries' is a reference to 'beneficiaries of an RSE within the RSE licensee's business operations'.

<sup>4</sup> For the purposes of this Prudential Standard, a reference to 'the Board' is a reference to the Board of directors or group of individual trustees of an RSE licensee and 'group of individual trustees' has the meaning given in section 10(1) of the SIS Act.

**RSE licensees that are part of a group<sup>5</sup>**

9. Where an RSE licensee is part of a corporate group, and the RSE licensee utilises group policies or functions, the Board must approve the use of group policies and functions and must ensure that these policies and functions give appropriate regard to the RSE licensee's business operations and its specific requirements.

**Material risks**

10. An RSE licensee must, at a minimum, ensure that its risk management framework covers all material risks, both financial and non-financial, to the RSE licensee's business operations, having regard to the size, business mix and complexity of those operations.
11. An RSE licensee must assess the materiality of each risk with reference to its business operations as a whole, each RSE within those operations and the impact of the risk on the obligations of the RSE licensee to its beneficiaries.
12. An RSE licensee's risk management framework must, at a minimum, cover:
- (a) governance risk<sup>6</sup>;
  - (b) investment governance risk<sup>7</sup>;
  - (c) liquidity risk, including the liquidity characteristics of investment options offered or proposed to be offered<sup>8</sup>;
  - (d) operational risk<sup>9</sup>;
  - (e) insurance risk<sup>10</sup>;
  - (f) strategic and tactical risks that arise out of the RSE licensee's strategic and business plans; and
  - (g) other risks that may have a material impact on the RSE licensee's business operations.
13. Where an RSE licensee conducts business that has a purpose other than superannuation<sup>11</sup>, its risk management framework must cover all material

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<sup>5</sup> For the purposes of this Prudential Standard, a reference to 'a group' is a reference to a group comprising the RSE licensee and all connected entities and all related bodies corporate of the RSE licensee, 'connected entity' has the meaning given in section 10(1) of the SIS Act and 'related body corporate' has the meaning given in section 50 of the *Corporations Act 2001*.

<sup>6</sup> Refer to *Prudential Standard SPS 510 Governance* (SPS 510), *Prudential Standard SPS 520 Fit and Proper* and *Prudential Standard SPS 521 Conflicts of Interest*.

<sup>7</sup> Refer to *Prudential Standard SPS 530 Investment Governance* (SPS 530).

<sup>8</sup> Refer to SPS 530.

<sup>9</sup> Refer to *Prudential Standard SPS 114 Operational Risk Financial Requirement* (SPS 114), SPS 231 and *Prudential Standard SPS 232 Business Continuity Management* (SPS 232).

<sup>10</sup> Refer to *Prudential Standard SPS 250 Insurance in Superannuation*.

<sup>11</sup> Refer to section 62 of the SIS Act for details of the sole purpose test to identify business that has a purpose other than superannuation.

contagion risks that any non-superannuation business conducted by the RSE licensee might have on the superannuation business.

### **Risk management framework**

14. An RSE licensee's risk management framework must enable the RSE licensee to develop and implement strategies, policies, procedures and controls to appropriately manage different types of material risk.
15. An RSE licensee's risk management framework must provide reasonable assurance that each material risk to the RSE licensee's business operations is being prudently and soundly managed, having regard to the size, business mix and complexity of those operations.
16. An RSE licensee's risk management framework must, at a minimum, include:
  - (a) the risk appetite statement;
  - (b) the risk management strategy (RMS);
  - (c) **a business plan that satisfies the requirements of Attachment A of this Prudential Standard;**
  - (d) a designated risk management function that meets the requirements of paragraph 30;
  - (e) all risk management policies, procedures and controls to identify, assess, monitor, report on, mitigate and manage each material risk;
  - (f) clearly defined and documented roles, responsibilities and formal reporting structures for the management of material risks throughout the RSE licensee's business operations;
  - (g) **a management information system(s) (MIS) that is adequate, both under normal circumstances and in periods of stress, for measuring, assessing and reporting on all material risks across the RSE licensee's business operations; and**
  - (h) a review process to ensure that the risk management framework remains effective.
17. Where an RSE licensee is part of a corporate group and any element of the RSE licensee's risk management framework is controlled or influenced by, or is subject to approval by another entity in the group, the RSE licensee's risk management framework must specifically take into account risks arising from group policy objectives and strategies, and clearly identify:
  - (a) whether the RSE licensee's risk management framework is derived wholly or partially from group risk management policies or functions;

- (b) the linkages and significant differences between the RSE licensee's risk management framework and group risk management policies or functions; and
- (c) the process for monitoring by, or reporting to, the group on risk management including the key procedures, the frequency of reporting and the approach to reviews.

### **Strategic and business planning**

18. An RSE licensee must maintain a written plan for its business operations that sets out its approach for the implementation of its strategic objectives (business plan) and satisfies the requirements set out in Attachment A of this Prudential Standard.
19. The business plan must be a rolling plan of at least three years' duration that is reviewed at least annually, with the results of the review reported to the Board. The business plan must cover the entirety of the RSE licensee's business operations and be approved by the Board.
20. An RSE licensee must identify and consider the material risks associated with the RSE licensee's strategic objectives and business plan, and must explicitly manage these risks through the risk management framework, including how changing these plans affects the risk profile of the RSE licensee's business operations.

### **Expense management**

21. An RSE licensee must establish and maintain an expenditure policy that sets out how it ensures that fund expenditure is consistent with its strategic objectives.
22. For the purposes of this Prudential Standard, fund expenditure relates to any cash outflow and expected future cash outflow from the assets of an RSE, including payments to and from reserves, not otherwise allocated to members' accounts.
23. The expenditure policy must be approved by the Board and, at a minimum, specify:
  - (a) how the RSE licensee will ensure that fund expenditure is consistent with its strategic objectives, and is planned for, in the RSE's business plan (planned expenditure);
  - (b) the controls and approval processes for fund expenditure by level and type of expenditure, including specific reference to unplanned expenditure; and
  - (c) the levels and types of expenditure either individually, or collectively (where multiple expenditures are related), that the RSE licensee

determines to be significant because of the size, complexity or duration of the expenditure or related expenditures.<sup>12</sup>

24. An RSE licensee must prepare a business case for each significant expenditure, whether planned or not. This business case must detail:
- (a) the purpose for the expenditure, including how it will contribute to the RSE licensee meeting its strategic objectives;
  - (b) whether the expenditure is reflected in the financial projections of the business plan;
  - (c) for expenditure that is not planned, the source of funding for the expenditure and the expected impact of the expenditure on the financial projections in the business plan;
  - (d) the metrics that the RSE licensee will use to measure whether the expenditure is achieving its intended purpose;
  - (e) the circumstances that would trigger a review of the expenditure decision, including whether any related future planned expenditure should take place; and
  - (f) where relevant, how the use of reserves as the source of funding for significant expenditure accords with the strategy formulated for the purposes of sections 52(2)(e) and 52(2)(i) of the SIS Act.

### **Risk appetite statement**

25. An RSE licensee must maintain an up-to-date risk appetite statement that covers the RSE licensee's business operations and each category of material risk. The risk appetite statement must be approved by the Board.
26. An RSE licensee's risk appetite statement must, at a minimum, articulate:
- (a) the degree of risk that the RSE licensee is prepared to accept in pursuit of its strategic objectives and business plan, giving consideration to the interests of beneficiaries (risk appetite);
  - (b) for each material risk, the maximum level of risk that the RSE licensee is willing to operate within expressed as a risk limit that, where possible, is based on a measurable limit of the risk remaining, after taking into account the mitigants for the risk where appropriate (risk tolerance);
  - (c) the process for ensuring that risk tolerances are set at an appropriate level, based on an estimation of the impact on the interests of beneficiaries in the event that a risk tolerance is breached and the likelihood that each material risk is realised;

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<sup>12</sup> For the avoidance of doubt, expenditure relating to those activities detailed in the business plan (as required by paragraph 3(a) of Attachment A) is to be treated by the RSE licensee as significant.

- (d) the process for monitoring compliance with each risk tolerance and taking appropriate action in the event of a breach of the RSE licensee's risk tolerance; and
- (e) the timing and process for review of the risk appetite and risk tolerances.

### **Risk management strategy**

- 27. An RSE licensee must maintain an up-to-date RMS for its business operations that covers each material risk identified under paragraphs 10 to 13 inclusive. The RMS must be approved by the Board.
- 28. An RMS is a strategic document that describes the RSE licensee's strategy for managing risk and the key elements of the risk management framework that give effect to this strategy. At a minimum, an RSE licensee's RMS must describe:
  - (a) each material risk identified under paragraphs 10 to 13 inclusive and the RSE licensee's approach to managing these risks;
  - (b) the policies and procedures dealing with the following risk management matters, including the date when each policy or procedure was last revised, the date that it is next due for review and who is responsible for the review:
    - (i) the processes for identifying and assessing material risks and controls;
    - (ii) the process for establishing, implementing and testing mitigation strategies and control mechanisms for material risks;
    - (iii) the process for monitoring, communicating and reporting risk issues, including escalation procedures for the reporting of material events and incidents;
    - (iv) the mechanisms in place for monitoring and ensuring ongoing compliance with all prudential requirements<sup>13</sup>; and
    - (v) the process for ensuring continued alignment between the risk management framework and the business plan;
  - (c) the role and responsibilities of the risk management function;
  - (d) the relationships between the Board, board committees and senior management with respect to the risk management framework;

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<sup>13</sup> 'Prudential requirements' include requirements under the SIS Act, the *Superannuation Industry (Supervision) Regulations 1994*, the prudential standards, reporting standards, the *Financial Sector (Collection of Data) Act 2001* (FSCOD Act), licence conditions, authorisations, superannuation data and payment standards, directions and any other requirements imposed by APRA under legislation.

- (e) those with managerial responsibility for the risk management framework, and their roles and responsibilities;
  - (f) the approach to ensuring all persons within the RSE licensee's business operations have awareness of the risk management framework and for instilling an appropriate risk culture across the RSE licensee's business operations; and
  - (g) the process by which the risk management framework is reviewed and the intended coverage and timing for these reviews.
29. APRA may require an RSE licensee to amend its RMS or develop and maintain a separate RMS with respect to one or more RSEs within its business operations where APRA considers that the RSE licensee's RMS does not adequately cover the risks to that RSE.<sup>14</sup>

### **Risk management function**

30. An RSE licensee must have a designated risk management function that, at a minimum:
- (a) is responsible for assisting the Board, board committees and senior management to develop and maintain the risk management framework;
  - (b) is appropriate to the size, business mix and complexity of the RSE licensee's business operations and is operationally independent from the business units of the RSE licensee;
  - (c) is resourced with staff who have clearly defined roles and responsibilities and who possess appropriate experience and qualifications to exercise those responsibilities;
  - (d) has access to all aspects of the RSE licensee's business operations that have the potential to generate material risk, including information technology systems and systems development resources;
  - (e) has the necessary authority and reporting structure to the Board, board committees and senior management to conduct its risk management activities in an effective and independent manner; and
  - (f) is required to notify the Board of any material deviation from, or material breach of, the risk management framework.
31. An RSE licensee that is part of a corporate group may rely on a risk management function located in another entity in the group where the risk management function satisfies the criteria set out in paragraph 30 in respect of the RSE licensee's business operations.

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<sup>14</sup> Where this Prudential Standard provides for APRA to require an RSE licensee to amend its RMS, or otherwise exercise a power or discretion, the power or discretion is to be exercised in writing.

32. An RSE licensee may engage the services of an external service provider to perform all or part of the risk management function where the RSE licensee can demonstrate to APRA that the external risk management function meets the requirements in paragraph 30.<sup>15</sup>

### **Review of the risk management framework**

33. An RSE licensee must ensure that the appropriateness, effectiveness and adequacy of its risk management framework are subject to a comprehensive review by operationally independent, appropriately trained and competent persons at least every three years.
34. An RSE licensee must also undertake, for each year during which a comprehensive review does not take place, a review of the appropriateness, effectiveness and adequacy of the risk management framework.
35. The scope of the comprehensive review of an RSE licensee's risk management framework must have regard to the size, business mix and complexity of the RSE licensee's business operations, the extent of any change to those operations or its risk appetite and any changes to the external environment in which the RSE licensee operates. The review of the risk management framework must, at a minimum, include a review of:
- (a) whether the risk management framework remains appropriate for the RSE licensee's business operations;
  - (b) **the specific resources utilised, at a minimum, to undertake the risk management activities required by this Prudential Standard and whether these activities are supported by adequate resources;**
  - (c) the risk appetite statement;
  - (d) the RMS, to ensure that it accurately documents the RSE licensee's risk management framework and the RSE licensee's strategy for managing risk;
  - (e) all risk management policies and procedures; and
  - (f) all risk management and internal control systems.
36. An RSE licensee must implement satisfactory internal audit procedures and external audit arrangements to ensure compliance with the risk management framework and enable the RSE licensee to attest that the risk management and internal control systems in place are operating effectively and are adequate.<sup>16</sup>
37. Where institutional, operational or other developments that materially affect the size, business mix and complexity of an RSE licensee's business operations are

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<sup>15</sup> Outsourcing of the risk management function by an RSE licensee must also meet the requirements in SPS 231.

<sup>16</sup> Refer to *Prudential Standard SPS 310 Audit and Related Matters* and SPS 510 for requirements relating to external audits and internal audits respectively.

identified outside the comprehensive review required in paragraph 33, the RSE licensee must assess whether any amendment to, or a review of, the risk management framework is necessary to take account of these developments.

### **Risk management declaration**

38. The Board must, on an annual basis, provide APRA with a declaration on risk management (risk management declaration) signed by two directors that satisfies the requirements set out in Attachment B of this Prudential Standard.
39. An RSE licensee must submit the risk management declaration to APRA on, or before, the day that the RSE licensee is required to submit annual information under reporting standards made by APRA under the Financial Sector (Collection of Data) Act 2001.
40. If the Board qualifies the risk management declaration, the qualified declaration must include a description of any material deviation from the RSE licensee's risk management framework and the steps taken, or proposed to be taken, to remedy those deviations.

### **Adequacy of resources**

[Paragraphs deleted]

### **Notification requirements**

41. An RSE licensee must notify APRA within 10 business days when it:
  - (a) becomes aware of a significant breach of, or material deviation from, the risk management framework; or
  - (b) discovers that the risk management framework did not adequately address a material risk.
42. An RSE licensee must notify APRA, as soon as practicable, when it becomes aware of any material changes to the size, business mix and complexity of the RSE licensee's business operations.

### **Adjustments and exclusions**

43. APRA may, by notice in writing to an RSE licensee, adjust or exclude a specific prudential requirement in this Prudential Standard in relation to that RSE licensee.<sup>17</sup>

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<sup>17</sup> Refer to section 34C(5) of the SIS Act.

**Attachment A****Strategic and business planning**

1. The Board must approve strategic objectives for the RSE licensee's business operations that support the delivery of the outcomes it seeks for beneficiaries and ensure the financial soundness of the RSE licensee's business operations.
2. The strategic objectives must be specific and measurable and informed by:
  - (a) the RSE licensee's risk appetite statement;
  - (b) the strategies formulated for each RSE consistent with the covenants in sections 52(2)(i), 52(6), 52(7) and 52(8)(a) of the SIS Act;
  - (c) the financial resources determined necessary to cover the operational risk that relates to the RSE under section 52(8)(b) of the SIS Act;
  - (d) the annual outcomes assessment<sup>18</sup>; and
  - (e) section 62 of the SIS Act.
3. An RSE licensee's business plan required under paragraph 18 of this Prudential Standard must, at a minimum, specify:
  - (a) the details and timing of the key activities that the RSE licensee will implement to achieve the Board's strategic objectives, including the expected outcomes of those activities;
  - (b) the key performance indicators that the RSE licensee will use to enable the outcomes of the activities to be reliably assessed;
  - (c) the forecasted revenue from fees to be charged to beneficiaries over the next three years and the RSE licensee's basis for setting the amount of these fees to be charged<sup>19</sup>;
  - (d) how the RSE licensee will apportion the revenue collected from fees to, where applicable, reserves, profit, dividend payments and expenses for the RSE licensee and each RSE; and
  - (e) the key assumptions that inform the RSE licensee's forecasts under paragraph 3(c) and how these assumptions take into account the material risks that have been identified by the risk management framework.
4. An RSE licensee must put in place a process for monitoring how the business plan is being implemented, including whether the Board's strategic objectives are likely to be achieved.

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<sup>18</sup> Refer to *Prudential Standard SPS 225 Outcomes Assessment* (SPS 225) for the requirement to undertake an annual outcomes assessment.

<sup>19</sup> Refer to Part 11A of the SIS Act.

5. The annual review of the business plan required in paragraph 19 of this Prudential Standard must take into account the most recent annual outcomes assessment and incorporate, where appropriate, any actions arising from that assessment.<sup>20</sup>

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<sup>20</sup> Refer to SPS 225.

**Attachment B****Risk management declaration**

For the purposes of paragraph 38 of this Prudential Standard, an RSE licensee's risk management declaration must cover the following matters:

- (a) the RSE licensee has in place systems for ensuring compliance with all prudential requirements;
- (b) the systems and resources that are in place for managing and monitoring risks, and the risk management framework, are appropriate to the RSE licensee, having regard to the size, business mix and complexity of the RSE licensee's business operations;
- (c) the RSE licensee has assessed the risks of outsourcing any business activity, and is satisfied that the risks and relevant controls relating to these risks are appropriate to the RSE licensee, having regard to the size, business mix and complexity of the RSE's licensee's business operations and the operational capabilities of the RSE licensee itself;
- (d) the risk management and internal control systems in place are operating effectively and are adequate having regard to the risks they are designed to control;
- (e) the RSE licensee has an RMS that complies with this Prudential Standard, and that the RSE licensee has complied with each measure and control described in the RMS;
- (f) the RSE licensee is satisfied with the efficacy of the processes and systems surrounding the production of financial information for each RSE within its business operations;
- (g) the RSE licensee has adequate reporting systems and internal controls supporting the preparation and reporting of accurate financial and statistical information to APRA; and
- (h) information provided to APRA accurately represents the transactions for the year and financial position at year end in accordance with the provisions of the SIS Act and FSCOD Act.