Response Paper

Strengthening Financial Resilience in Superannuation

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Executive summary

The superannuation industry and operating environment has materially evolved since APRA's initial introduction in 2013 of prudential requirements and guidance on trustee financial resilience and reserving for operational risk events.

APRA has observed that, despite having built fully funded operational risk reserves, many RSE licensees have been reluctant to call on these reserves, even where they are entitled to do so. Instead, RSE licensees are using other reserves or external sources of capital following an operational risk event.

In February 2024, APRA released a consultation letter outlining proposed enhancements to the prudential framework on the operational risk financial requirement (ORFR).[1] This followed earlier consultations in November 2021 and November 2022.

The proposed enhancements clarify the purpose of the ORFR, widen the allowable range of uses for the ORFR, introduce a clear and direct relationship with *Prudential Standard CPS 230 Operational Risk Management* (CPS 230), and amend the APRA notification requirements to facilitate further use of the ORFR.

Following feedback from industry and other stakeholders, APRA is now finalising changes to *Prudential Standard SPS 114 Operational Risk Financial Requirement* (SPS 114) and *Prudential Practice Guide SPG 114 Operational Risk Financial Requirement* (SPG 114).

In general, APRA remains of the view that 0.25% of funds under management (FUM) remains an appropriate industry benchmark for the ORFR target amount. However, APRA also appreciates that this simple benchmark does not appropriately account for the increasing scale of larger funds.

Accordingly, APRA has amended its guidance to specify lower minimum ORFR target amounts for larger funds. Specifically, 0.20% and 0.175% of FUM for RSE licensees with greater than $30 billion and $165 billion in FUM respectively.

Given the revised guidance now provides flexibility for larger RSE licensees to adopt a lower percentage-based target amount, APRA has also revised its guidance on regulatory engagement.

This approach prioritises simplicity, including to reduce regulatory burden for RSE licensees, while making reasonable accommodation for large scale funds.

[1] APRA's consultation is available here: Strengthening Financial Resilience in Superannuation | APRA.

Consultation feedback

APRA received 11 submissions in response to its February 2024 consultation letter and the draft standard and guidance. Submissions were generally supportive of the proposed enhancements. However, some submissions identified areas for amendment, greater clarity and additional guidance.

Key matters raised in the submissions included:

amending the guidance for the minimum ORFR target amount, particularly for larger funds, to avoid over reserving;

greater clarity regarding APRA's expectations where RSE licensees intended to adopt an ORFR target amount below 0.25% of FUM, with stakeholders querying the nature of the process and the extent of data and analysis required to support the RSE licensee's conclusions; and

additional guidance on developing a holistic view of capital and reserving frameworks and practices.

This Response Paper summarises the key substantive feedback from industry and other stakeholders, and sets out APRA's response.

In conjunction with this Response Paper, APRA is releasing updated final versions of SPS 114 and SPG 114.

Commencement date

In the February 2024 consultation letter, APRA proposed that SPS 114 would commence in July 2025, to align with CPS 230. There were no objections raised in the submissions to this, and APRA will proceed with this later commencement date for both SPS 114 and SPG 114.

Glossary

APRA	Australian Prudential Regulation Authority
CPS 190	*Prudential Standard CPS 190 Recovery and Exit Planning*
CPS 230	*Prudential Standard CPS 230 Operational Risk Management*
CPS 900	*Prudential Standard CPS 900 Resolution Planning*
FUM	For the purposes of this Response Paper, APRA views funds under management (FUM) as the total of asset balances of each RSE within the RSE licensee's business operations
ORFR	Operational risk financial requirement
PPG	Prudential practice guide
PST	Pooled Superannuation Trust
RSE	Registrable superannuation entity as defined in section 10(1) of the *Superannuation Industry (Supervision) Act 1993*
RSE licensee	RSE licensee as defined in section 10(1) of the *Superannuation Industry (Supervision) Act 1993*
SFI	Significant financial institution
SIS Act	*Superannuation Industry (Supervision) Act 1993*
SPS 114	*Prudential Standard SPS 114 Operational Risk Financial Requirement*
SPG 114	*Prudential Practice Guide SPG 114 Operational Risk Financial Requirement*

Key matters raised in submissions

Key matters raised in submissions and APRA's response are summarised below.

APRA also considered a number of minor requests for further clarification which have been reflected in the amended versions of SPS 114 and SPG 114 where appropriate.

1.1 Guidance for minimum target amount and APRA engagement

APRA's draft SPG 114 included guidance to the effect that APRA considered 0.25% of FUM to be an industry benchmark for the ORFR target amount but, in exceptional cases, a significant financial institution (SFI) could adopt a lower target amount following engagement with APRA against a set of specified criteria.[2]

Comments received

A number of submissions endorsed APRA moving away from the more complicated approach set out in earlier consultation (i.e. the previously proposed 'Baseline+ model') but reiterated a 0.25% of FUM target amount was unnecessarily high, especially for larger funds.

Further, a number of submissions raised concerns with the nature, type and extent of engagement that APRA expected. Some submissions also raised concerns regarding the robustness and costs of operational risk modelling in the context of the superannuation industry.

APRA's response

In general, APRA remains of the view that 0.25% of FUM remains an appropriate industry benchmark for the target amount. However, APRA accepts this simple benchmark does not appropriately take into account the increasing scale of larger funds.

APRA has determined to further simplify the nature of guidance provided regarding the ORFR target amount, as set out in the table below. An RSE licensee remains responsible for setting the ORFR target amount, appropriate for the circumstances of the RSE(s) under trusteeship and having regard to all relevant factors, including those outlined in SPS 114.

Funds Under Management (FUM)	APRA guidance on minimum ORFR target amount
Greater than $165 billion	0.175% of FUM
Between $30 billion and $165 billion (inclusive)	0.20% of FUM
Less than $30 billion (inclusive)	0.25% of FUM

[2] Refer to *Prudential Standard CPS 190 Recovery and Exit Planning* and *Prudential Standard CPS 900 Resolution Planning* for the definition of SFI.

Given this change, and noting APRA's expectation that RSE licensees will determine their ORFR target amount in line with the guidance, APRA is no longer proposing that RSE licensees must engage with APRA prior to adopting a target amount lower than 0.25% of FUM.

APRA's approach is intentionally simple, including an intent to reduce regulatory burden on RSE licensees in circumstances where there may not be commensurate prudential benefit.

APRA has retained the requirement for RSE licensees to notify APRA prior to making a material change to the ORFR target amount. Finally, it remains the case under SPS 114 that APRA may require an RSE licensee to meet an ORFR target amount determined by APRA within a specified time where the RSE licensee's target does not appropriately reflect the operational risks of the RSE licensee's business operations.

1.2 Permissible uses

APRA remains committed to expanding the uses of the ORFR to a wider range of circumstances related to managing the financial impact of operational risks that relate to an RSE.

Comments received

Submissions supported widening the range of permissible uses of the ORFR. In particular, to meet the requirements of CPS 230 and for the effective management and prevention of operational risk incidents (including the remediation of identified material weaknesses). Submissions also requested further guidance on the permissible uses of ORFR financial resources.

Whilst submissions supported widening the permissible uses for the ORFR to include preventative actions, some concerns were raised with the risk of overuse of the ORFR on preventative actions, resulting in the erosion of ORFR financial resources.

Submissions queried why the definition of 'operational risk', which is incorporated in the current version of SPS 114 (2013 version), was removed from draft SPS 114.

APRA's response

APRA has made minor amendments to the prudential requirements and related guidance, on both the appropriate and inappropriate uses of ORFR financial resources. A range of situations and scenarios on the uses of the ORFR are included in SPG 114.

The expanded permissible uses, coupled with the reduced notification requirements upon use, have been designed to enable RSE licensees to routinely use the ORFR financial resources. Clear expectations on the processes and parameters for determining when and how the ORFR financial resources can be used are addressed to avoid the risk of overuse of the ORFR.

APRA has removed the definition of 'operational risk' from SPS 114 but has established a clear link with CPS 230 in SPS 114. CPS 230 refers to operational risks as "risks that may result from inadequate or failed internal processes or systems, the actions or inactions of people or external drivers or events. Operational risk is inherent in all products, activities, processes and systems" (paragraph 13 of CPS 230). This approach, of not re-defining operational risk in SPS 114, aligns with APRA's intention to centralise definitions and references in a single prudential standard where they concern the same matter.

1.3 Guidance target amount – Other APRA financial requirements

Where the assets of an RSE are invested in another entity that is subject to SPS 114 or another APRA financial requirement relating to operational risk, APRA has enabled the RSE licensee of the RSE to reduce its ORFR target amount to avoid duplication of reserving. The draft SPG 114 issued as part of the consultation only referenced Pooled Superannuation Trusts (PSTs).

Comments received

Submissions were received to retain the scope of the current guidance (2013 version) enabling RSEs that are invested in a PST or another entity that is subject to SPS 114, or another APRA financial requirement relating to operational risk, to reduce the ORFR target amount.

APRA's response

APRA has amended the guidance in SPG 114 to support RSEs that invest in a PST or another entity outside of the RSE licensee's business operations which is subject to SPS 114 or another financial requirement relating to operational risk, to adopt an ORFR target amount that would be at least 0.10% of FUM of the PST or the other entity.

1.4 Frequency of review of target amount and tolerance limit

SPS 114 requires RSE licensees to undertake an annual review of their ORFR target amount and tolerance limit.

Comments received

Some submissions advocated for reducing the frequency of review, for instance to every three years.

APRA's response

APRA considered reducing the frequency of reviews. Ultimately, given the other simplification changes made, APRA determined to retain the requirement for an annual review, having regard to the potential for material changes in an RSE licensee's business operations and/or operational risk profile over the course of a year.

However, APRA notes that the scope and nature of the review undertaken will depend on the RSE licensee's specific circumstances. For instance, for RSE licensees that have set the ORFR target amount at 0.25% of FUM, the review might be relatively straightforward in the absence of material developments. Further, APRA notes the depth and scope of the review undertaken by an RSE licensee does not have to be the same every year.

1.5 Holistic view of capital and reserving

APRA proposed enhancements which focussed on clarifying the purpose of the ORFR and expanding the range of permissible uses for the ORFR for operational risk management. The proposed enhancements did not contemplate extending prudential requirements to encompass a holistic view of capital and reserving for risk mitigation.

Comments received

Some submissions advocated for expanding the requirements to take a more holistic view of an RSE licensee's capital and reserving frameworks.

APRA's response

APRA notes the increasing appetite for more sophisticated and holistic capital and reserving prudential requirements from some industry participants, however, APRA is not proposing further changes at this time.