



## Prudential Standard SPS 114

### Operational Risk Financial Requirement

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

*Prudential Standard SPS 114 Operational Risk Financial Requirement (SPS 114) is a **prudential standard** in the **business operations pillar** of APRA's superannuation prudential framework. The Operational Risk Financial Requirement (ORFR) requires RSE licensees to maintain, manage and utilise, in accordance with this Prudential Standard, financial resources to protect beneficiaries from losses due to operational risks that relate to the RSEs within its business operations. Key requirements include having a documented ORFR strategy, an ORFR target amount and tolerance limit. An RSE licensee must maintain ORFR financial resources which must be used in a manner consistent with the ORFR and the overarching legislative requirements.*

#### Authority

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

#### Application and commencement

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.~~
- ~~4.3.~~ The requirements of this Prudential Standard apply for the purposes of section 52(8)(b) of the SIS Act.

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

5.4. This Prudential Standard commences on 1 July 20132025 (effective date).

### **Interpretation**

5. Where this Prudential Standard provides for APRA to exercise a power or discretion, the power or discretion is to be exercised in writing.

### **Adjustments and exclusions**

6. APRA may, ~~by notice in writing to an RSE licensee,~~ adjust or exclude a specific ~~prudential~~ requirement in this Prudential Standard in relation to:

(a) ~~a particular that~~ RSE licensee of an RSE; or

(a)(b) specific RSE licensees of RSEs.

### **Previous exercise of discretion**

7. An RSE licensee must contact APRA if it seeks to place reliance, for the purposes of complying with this Prudential Standard, on an exercise of discretion by APRA made under a previous version of this Prudential Standard.

### **RSE licensees that are part of a group<sup>2</sup>**

6.8. 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 ~~have give~~ appropriate regard to the RSE licensee's business operations.

### **Operational risk financial requirement**

9. An RSE licensee must maintain, manage and utilise, in accordance with this Prudential Standard, financial resources to protect beneficiaries from losses due to operational risks<sup>3</sup> that relate to the RSEs within its business operations.<sup>4</sup>

6. ~~For the purposes of this Prudential Standard, an 'operational risk' is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. This definition includes legal risk but excludes strategic and reputational risk.~~

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<sup>2</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 subsection 10(1) of the SIS Act ~~and 'related body corporate' has the meaning given in section 50 of the Corporations Act 2001.~~

<sup>3</sup> Refer to Prudential Standard CPS 230 Operational Risk Management for a description of operational risks at paragraphs 13 and 24.

<sup>4</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.

~~7. For the purposes of this Prudential Standard, an ‘operational risk event’ is an operational risk that has:~~

- ~~(a) materialised; and~~
- ~~(b) caused one or more beneficiaries in an RSE to sustain a loss, or to be deprived of a gain to which they otherwise would have been entitled, in relation to their benefits in that RSE.~~

## ORFR strategy

~~7.10. An RSE licensee must formulate and give effect to an ORFR strategy that sets out how it will meet the ORFR. At a minimum, the ORFR strategy must include the RSE licensee’s: have a strategy, approved by the Board, for meeting the ORFR target amount (ORFR strategy).<sup>5</sup> The Board is ultimately responsible for ensuring the implementation of an RSE licensee’s ORFR strategy.~~

~~18. At a minimum, an RSE licensee’s ORFR strategy must describe:~~

- ~~(a) the factors that influence the size of the ORFR target amount and the tolerance limit, including how and why it has determined these amounts to be appropriate amounts that the RSE licensee determines are required for each of the components in paragraph 8;~~
- ~~(b) whether the RSE licensee will use the method described in paragraph 14(a), (b) or (c) to meet the ORFR target amount and the steps that it takes to ensure that it complies with paragraph 12;~~
- ~~(b) the processes and parameters for determining when and how the ORFR financial resources can be used; the RSE licensee will apply to ensure that the requirements in paragraphs 15 and 16 (as applicable) are met on an ongoing basis;~~
- ~~(c) approach to holding the ORFR financial resources, including how the RSE licensee will ensure that the requirements in paragraphs 16 and 17 (as applicable) are met on an ongoing basis;~~
- ~~(d) how the RSE licensee has regard to the requirements of section 52(8)(b) of the SIS Act in relation to each RSE;~~
- ~~(e)(d) the investment strategy for maintaining any operational risk reserves held to meet the ORFR target amount;~~
- ~~(f) the process for determining when and how the financial resources held to meet the ORFR target amount can be called upon;~~

<sup>5</sup> Under section 52(2)(i) of the SIS Act, an RSE licensee that holds reserves is required to have a strategy for their prudential management. The requirement to have an ORFR strategy is in addition to the requirement for an RSE licensee to have a general reserving strategy (where reserves in addition to those used to meet the ORFR target amount are held within the RSE).

~~(g)(e) the process for implementing a replenishment plan in accordance with paragraph 1820 (replenishment plan);~~

~~(h)(f) review the processes for monitoring and reviewing the adequacy of the ORFR target amount, tolerance limit and ORFR strategy; and including the steps to be taken to ensure the ORFR target amount remains at an appropriate level in the event of changes such as:~~

~~(i) a significant change in the size, business mix and complexity of an RSE within the RSE licensee's business operations; or~~

~~(j) —~~

~~(k) — (ii) — the wind-up of an RSE; and~~

~~(l)(g) (i) the process for managing the financial resources held to meet the ORFR target amount in the event that the RSE licensee or RSE is wound up.~~

11. The Board must approve the ORFR strategy and is ultimately accountable for ensuring the implementation of the RSE licensee's ORFR strategy.

### **ORFR target amount and tolerance limit**

12. For the purposes of paragraph 9, aAn RSE licensee must determine:

(a) a target amount of financial resources (ORFR target amount); and

(b) a tolerance limit below the ORFR target amount (tolerance limit). ~~Where ORFR financial resources fall below the tolerance limit, that reflects the level below which the RSE licensee must take action to replenish financial resources held to meet the ORFR target amount. The tolerance limit must have regard to the size, business mix and complexity of the RSE licensee's business operations and be approved by the Board.~~

13. An RSE licensee's ORFR target amount and tolerance limit must be determined on a prudent basis that suitably reflects:

(a) the RSE licensee's operational risk profile and risk assessments;

(b) the uses of the ORFR financial resources permitted under paragraph 15; and

(c) the size, business mix and complexity of the RSE licensee's business operations.

8.14. If APRA considers that the ORFR target amount and/or tolerance limit set by the RSE licensee does not adequately reflect the requirements of this Prudential Standard, APRA may require an RSE licensee to<sup>6</sup>:

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<sup>6</sup> ~~Where this Prudential Standard provides for APRA to require an RSE licensee to meet a specific ORFR target amount or tolerance limit, or otherwise exercise a power or discretion, the power or discretion is to be exercised in writing.~~

~~(e)(a)~~ meet an ORFR target amount determined by APRA, within a specified time; ~~and/or~~

~~(d)(b)~~ adopt a tolerance limit determined by APRA

~~if APRA considers that the ORFR target amount or tolerance limit set by the RSE licensee, as relevant, does not appropriately reflect the operational risks of the RSE licensee's business operations.~~

~~8. The Board is ultimately responsible for ensuring that the RSE licensee holds, and has unfettered access to, financial resources to meet the ORFR target amount.~~

### **Use of ORFR financial resources ~~held to meet the ORFR target amount~~**

~~15. 17.~~ An RSE licensee ~~must~~ may only use ORFR ~~the~~ financial resources for one or more of the following: ~~held to meet the ORFR target amount to make a payment to address an operational risk event or to enable it to meet the requirements in paragraphs 19(h) and (i) inclusive.~~

~~(a) to address operational risks that could reasonably be considered to have caused or could cause one or more beneficiaries in an RSE within the RSE licensee's business operations to sustain a loss, or to be deprived of a gain to which they otherwise would have been entitled;~~

~~(b) to meet the requirements of *Prudential Standard CPS 230 Operational Risk Management* for the effective management and prevention of operational risk incidents, including the remediation of identified material weaknesses and maintenance of critical operations within tolerance levels through severe disruption; and~~

~~(c) to reduce a surplus where ORFR financial resources are materially larger than the ORFR target amount.~~

### **Access to ORFR ~~f~~Financial resources to meet the ORFR target amount**

~~9. The financial resources held to meet the ORFR target amount must be held either as:~~

~~(a) an operational risk reserve held within an RSE;~~

~~(b) operational risk trustee capital held by the RSE licensee; or~~

~~(c) a combination of both an operational risk reserve held within an RSE and operational risk trustee capital held by the RSE licensee.~~

~~10.16.~~ To be eligible to meet the ORFR target amount, any ORFR financial resources held as an operational risk reserve ~~held~~ within an RSE must:

~~(d)(a)~~ be separately identifiable from member accounts and reserves held in the RSE for other purposes; and

~~(e)(b) be provide an unrestricted and readily available to address commitment of financial resources to address losses arising from~~ operational risks in a timely manner.<sup>7</sup>

~~11.17.~~ To be eligible to be used to meet the ORFR target amount, any ORFR financial resources held as operational risk trustee capital must be held in a form that is equivalent to Common Equity Tier 1 capital.<sup>8</sup>

## Shortfall management

~~12.18. Where If~~ the level of ORFR financial resources ~~held to meet the ORFR target amount~~ falls below the tolerance limit, an RSE licensee must implement a replenishment plan and replenish the ORFR financial resources. ~~The Replenishment plan must seek to replenish the level of financial resources held to meet the ORFR target amount occur~~ within a reasonable period and in a manner ~~that ensures that~~ the RSE licensee determines will ensure that the RSE licensee acts fairly in dealing with beneficiaries and minimises the risk of adverse outcomes for beneficiaries.<sup>9</sup> The replenishment plan must, at a minimum, explain:

- (a) how the shortfall has arisen;
- (b) the amounts that apply in relation to each RSE;
- (c) how the RSE licensee will replenish the ORFR financial resources, ~~held to meet the ORFR target amount~~, including the source of funding; and
- (d) the expected date for the RSE licensee to again meet the ORFR target amount.

~~13.19.~~ An RSE licensee's replenishment plan must be approved by the Board prior to implementation.

~~14.20.~~ APRA may require an RSE licensee to revise its replenishment plan if APRA considers that the plan does not not comply with the RSE licensee's duties and obligations meet the requirements of this Prudential Standard.

## Review and audit

~~15.~~ ~~An RSE licensee must review its ORFR target amount and tolerance limit annually to ensure that the ORFR target amount and tolerance limit are adequate based on the size, business mix and complexity of the RSE licensee's business~~

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<sup>7</sup> Refer also to Prudential Standard SPS 515 Strategic Planning and Member Outcomes for requirements relating to the prudent management of reserves.

<sup>8</sup> Prudential Standard APS III Capital Adequacy: Measurement of Capital states that Common Equity Tier 1 Capital comprises the highest quality components of capital elements that fully satisfy all of the following essential characteristics: (a) it provides a permanent and unrestricted commitment of funds; (b) is are freely available to absorb losses; (c) does not impose any unavoidable servicing charges against earnings; and (d) ranks behind the claims of depositors and other creditors in the event of winding-up of the issuer.

<sup>9</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'.

~~operations, and that the ORFR target amount and tolerance limit suitably reflect the operational risks identified in the RSE licensee's risk management framework.~~

- ~~16.21.~~ An RSE licensee must review the appropriateness of its ORFR target amount and tolerance limit following any material change to the operational risks identified in its risk management framework or the size, business mix and complexity of an RSE within its business operations.
- ~~17.22.~~ An RSE licensee must implement satisfactory internal audit procedures and external audit arrangements to ensure compliance with, and the adequacy and effectiveness of, the ORFR strategy.<sup>10</sup>
23. APRA may require the appointment of an appropriate external expert to provide an assessment of, and report on, the adequacy and effectiveness of, the RSE licensee's ORFR strategy. The report must be paid for by the RSE licensee and must be made available to APRA within 10 business days after it has been provided to the RSE licensee.

### Notification requirement

- ~~24.—27.~~ An RSE licensee must notify APRA prior to making a making a material change to the ORFR target amount., ~~within 10 business days, if:~~
- ~~(a) it determines the ORFR target amount must be adjusted to ensure ongoing compliance with this Prudential Standard;~~
  - ~~(b) the financial resources have fallen below the tolerance limit;~~
  - ~~(c) the RSE licensee becomes aware of an emerging operational risk event, or combination of emerging operational risk events, that would require the use of a material amount of the financial resources held to meet the ORFR target amount;~~
  - ~~(d) the RSE licensee becomes aware that an operational risk event has occurred that it determines may require the use of a material amount of the financial resources held to meet the ORFR target amount; or~~
  - ~~(e) any other RSE licensee determined material trigger event has occurred that may require the use of financial resources held to meet the ORFR target amount.~~

### Transitional arrangements

- ~~25.—~~ An RSE licensee ~~must build the financial resources to meet the ORFR target amount within three years of the effective date in a manner that ensures that the RSE licensee acts fairly in dealing with beneficiaries.~~

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<sup>10</sup> Refer to *Prudential Standard SPS 310 Audit and Related Matters* and *Prudential Standard SPS 510 Governance* for requirements relating to external and internal audits respectively.

- ~~26. An RSE licensee must develop a plan for implementing its ORFR strategy and building the financial resources to meet the ORFR target amount (transition plan). The transition plan must, at a minimum, set out:~~
- ~~(a) how the RSE licensee will build sufficient financial resources to meet the ORFR target amount; and~~
  - ~~(b) the expected date for the RSE licensee to meet the ORFR target amount for the RSE licensee's business operations. If the expected date for an RSE within the RSE licensee's business operations meeting the ORFR target amount differs from the expected date for the business operations as a whole, the transition plan must also set out the expected date(s) for each RSE(s).~~
- ~~27. The transition plan must be approved by the Board before it is implemented and at any time it is materially revised. An RSE licensee must submit a copy of the transition plan to APRA within 10 business days of Board approval.~~
- ~~29. An RSE licensee that holds a class of licence that enables it to be trustee of a public offer entity must continue to comply with the obligations imposed by the previous section 29D(1)(g) and section 29DA of the SIS Act<sup>11</sup>, as in force immediately prior to 1 July 2013, until it has met the ORFR target amount for the first time.~~
- ~~30. An RSE licensee must notify APRA, within 10 business days:~~
- ~~(a) when the ORFR target amount is met for the first time;~~
  - ~~(b) if the RSE licensee has formed the view that it is unlikely to be able to meet the ORFR target amount within the original timeframe specified in the transition plan; or~~
  - ~~(c) if there has been a material change to, or deviation from, the transition plan, together with an explanation for the change or deviation.~~

~~28.24.~~

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<sup>11</sup> In so complying, the RSE licensee must assume that regulation 3A.04 of *Superannuation Industry (Supervision) Regulations 1994*, and the forms of guarantee approved for the purposes of subsections 29DA(3) and (4) of the SIS Act, as in force immediately prior to 1 July 2013, continue in force. If, immediately prior to 1 July 2013, section 29DA(5) applied to the RSE licensee, the RSE licensee must assume that the written requirements relating to the custody of assets referred to in that subsection, and the RSE licensee's agreement in writing to comply with them, as applicable immediately prior to 1 July 2013, continue to apply.