Actuaries Institute.

13 May 2024

General Manager, Policy
Australian Prudential Regulation Authority

Email: superannuation.policy@apra.gov.au

Dear Sir/Madam,

Consultation: Financial resources for risk events in superannuation: Operational Risk Financial Requirement

The Actuaries Institute ('the Institute') welcomes the opportunity to make a submission to this consultation. The Institute is the peak professional body for actuaries in Australia. Our members have had significant involvement in the development and management of superannuation within Australia.

The consultation seeks industry feedback on proposed amendments to Prudential Standard SPS 114 Operational Risk Financial Requirement ('SPS 114') and the guidance supporting it, Prudential Practice Guide SPG 114 Operational Risk Financial Requirement ('SPG 114'). The proposed amendments reflect a simpler approach to the Baseline+ model proposed in APRA's Discussion paper - Financial resources for risk events in superannuation - dated November 2022 ('Discussion Paper'). The Institute supports the expected outcomes of the proposed amendments to SPS 114 and SPG 114, that is to better position RSE licensees ('RSEL') to use the Operational Risk Financial Requirement ('ORFR') actively for its intended purpose, while also simplifying its implementation.

The Institute supports key elements of the APRA proposal, in particular:

- Maintaining the existing guideline minimum target amount for the ORFR of 25 basis points of funds under management ('FUM'), which provides a consistent industry reference baseline against which an RSEL can undertake its ORFR target amount assessment.
- Widening the range of uses for the ORFR and providing flexibility in some circumstances to adopt a lower (than 25 basis points) ORFR target amount. The Institute believes this will encourage RSELs to take a more proactive lead on their annual ORFR assessment, while noting this flexibility (RSEL led method) would only be feasible for RSELs that are significant financial institutions (which APRA defines to include RSELs with total assets above AUD $30 billion).
- Introducing a direct link with Prudential Standard CPS 230 Operational Risk Management ('CPS 230') encourages RSELs to adopt an integrated approach to operational risk management that better integrates the SPS 114 and CPS 230 requirements into a single risk-based capital prudential framework.

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While the Institute is concerned that most RSELs will continue to adopt a compliance approach by selecting the existing guideline of 25 basis points of FUM as the minimum requirement, the proposed amendments give the opportunity for the RSELs that are significant financial institutions to 'lead the way' in bringing a more sophisticated approach to integrating risk, capital and reserve management into the superannuation industry.

The Institute supports an evolutionary approach to bringing the sophistication of integrated risk, capital and reserve management in the superannuation fund industry closer in line with the other APRA-regulated sectors (i.e., insurance and banking) over time. Our April 2022 Research Paper *Uplifting Superannuation Risk-Based Capital Management* ('RBCM') recommends an approach where RSELs identify, assess and prioritise all available capital, reserve and contingent structures, for example operational risk reserve (held in the RSE and held as capital within the RSEL), strategic reserve and capital, insurance policies and indemnities offered by third parties. Our Research Paper discussed how each structure should have clearly articulated objectives with an integrated RBCM framework, particularly for larger RSELs, that set out how each structure is prioritised under different "capital need" scenarios.

The Institute acknowledges that SPG 114 does not consider all capital, reserve and contingent structures, and that it should be read in conjunction with the shortly to be released SPG 515. Assuming that there is no additional guidance in SPG 515, the Institute recommends the following further guidance in SPG 114 to support those RSELs that are more capable of developing an RSEL led method:

- *Additional Guidance on "Usage Guardrails"* - While broadening the scope for use of ORFR will offer greater flexibility to RSELs, it is important for there to be clear guardrails in SPG 114 that would help a Trustee avoid using the ORFR inappropriately. Draft SPG 114 paragraphs 12 and 13 provide some guidance on usage guardrails, but the Institute recommends additional guidance for when ORFR should be prioritised. For example, an RSEL will need to determine at what point project expenditure to develop pre-emptive controls that provide early warning signals and address potential operational risks falls outside of the intent of the ORFR, and rather falls inside strategic spend to improve member outcomes. An integrated RBCM framework would outline clear guardrails for when ORFR should be prioritised relative to other capital, reserve and contingent structures.
- *Outlining an Approach to Developing an Integrated RBCM Framework* - The Institute believes that an integrated framework that brings together all RBCM related policies and frameworks covering the RSEL and its RSE(s) would more closely link SPS 114 and CPS 230. This framework would describe how their RSEL Risk Management Framework (including the Risk Appetite Statement and Risk Management Strategy), Defined Benefit Policy, liquidity management plan, ORFR strategy, management of reserves policy and potentially capital and dividend policy work holistically to support the interests of members. APRA could consider further guidance in SPG 114 to describe how an RSEL (particularly larger ones considering an RSEL led method) could develop and apply such an integrated framework.
- *Guidance on Development of ORFR Strategy Objectives* - There is limited guidance on how an RSEL is to articulate the ORFR Strategy objectives that must be documented in the RSEL's ORFR Strategy under draft SPS 114 paragraph 9. As previously mentioned, the Institute recommends SPG 114 be extended to encourage RSELs to not examine the ORFR in isolation but to consider all capital, reserve and contingent structures through an integrated RBCM Framework. Formulating objectives for each structure in this holistic manner will mitigate the risk of developing competing or duplicate objectives. It will also minimise the risk of gaps where certain RSEL / RSE risk exposures are not covered by financial capital from any structure.

The Institute would be pleased to discuss this submission. If you would like to do so, please contact me on [redacted] or [redacted]

Yours sincerely

[redacted]

CEO