Actuaries Institute

Superannuation Prudential Standards (SPSs)

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Introduction / Background

- Cooper review => Stronger Super
  - APRA to be given standards-making powers
  - Prudential standard on funding of vested benefits (VB)
  - Requirements for Operational Risk Reserves
  - Restrictions on self-insurance
- APRA standards discussion paper Sept 2011
- Draft standards released April 2012
- 12 ‘Final’ standards released November 2012
- Draft Prudential Practice Guides to follow

Agenda

- SPS 160 – Defined Benefit Matters
- SPS 520 – Fit and Proper
- SPS 521 – Conflicts of Interest
- SPS 114 – Operational Risk Financial Requirement (ORFR)
- SPS 220 – Risk Management
- SPS 530 – Investment Governance

SPS 160 – Regular actuarial investigations

- Timing similar to current
  - Annually if <5 members and paying DB pension
  - Annually or as agreed with APRA if >4 members and paying DB pension
  - Otherwise triennial
- Requirements apply to DB sub-funds
- Timing for reports
  - 12 months for valuation dates up to 30 June 2013
  - 9 months for valuation dates 1 July 2013 to 30 June 2016
  - 6 months for valuation dates from 1 July 2016
- ORFR must be excluded in determining if a fund is unsatisfactory or outside its shortfall limit
- Report must include amount of minimum benefits, 3 year projection and, if unsatisfactory, compliant restoration plan recommendations

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Shortfall limits

- A ‘shortfall limit’ is the extent to which an RSE licensee considers that a fund can be in an unsatisfactory financial position with the RSE licensee still being able to reasonably expect that, because of corrections to temporary negative market fluctuations in the value of fund assets, the fund can be restored to a satisfactory financial position within one year
- May be determined with advice from actuary
- Can be nil; must not result in technical insolvency
- Method of expression yet to be specified
- Trustee must establish a monitoring process to detect breaches on a timely basis
- SPC taskforce to prepare guidance on advice on shortfall limits

Interim actuarial investigations

- Required if shortfall limit is (or may be) breached unless:
  - (i) Next regular investigation due within 6 months or
  - (ii) An investigation already in progress, a restoration plan already in place or technically insolvent
- If (i) applies, must seek actuary's advice of any action required in interim
- Can bring forward regular investigation in lieu of interim
- No limits specified on valuation date (may be in PPG?)
- Interim investigation report required within 3 months from later of valuation date and date shortfall breach identified

Interim actuarial investigations (cont'd)

- Report must include 'a reasonable estimate' of net assets excluding ORFR and whether shortfall limit breached
- If report says shortfall limit breached, actuary must, within 15 business days, recommend actions to be taken including:
  - (i) A contribution program to restore 100% VBI within 3 years of later of valuation date and date shortfall breach identified, or
  - (ii) A date by which (i) will be provided
- Trustee then has 3 months to determine, agree, set out & implement a compliant restoration plan
  - Including consultation with employer(s) and actuary
  - Appointment of responsible actuary during UFP period
  - Actuary to advise on benefit payment reductions/deferral

Trustee's Restoration Plan

- Must outline:
  - Likelihood conts will be paid as recommended
  - Any changes to be made to investment strategy
  - Likely impact on benefit payments during restoration period
  - Monitoring and review process
- APRA may require changes and impose reporting requirements
- If progress unsatisfactory, APRA may:
  - Allow a variation in the funding period
  - Require the trustee to seek further actuarial advice
- Transitional arrangements may apply if UFP prior to 1 July 2013

Self-insurance (SI)

- SI to be restricted to DBs in DB (sub) funds that currently self-insure
- Trustee must:
  - Maintain reserves or ‘other arrangements approved by APRA’ to fund SI liabilities
  - Ensure ongoing actuarial oversight of SI and obtain an actuarial assessment at least every 3 years; triennial review report must contain enough info to demonstrate extent and adequacy of oversight
  - Annually attest that SI continues to be in members’ best interests
  - Develop a contingency plan for moving to external insurance
  - Comply with SPS 250 (Insurance in Superannuation)

SPS 160 wrap-up

- Good outcome, most of Institute's recommendations adopted
- Remaining areas of concern:
  - Practical determination of shortfall limits
  - APRA approvals of extensions to restoration periods likely to be frequently sought
  - No new powers to restrict benefit payments in UFP
  - No changes to technical insolvency/FSC requirements

SPS 520 Fit and Proper (F&P)

- Appointed actuary is a ‘responsible person’ of trustee
- Must meet F&P requirements
- Never convicted of dishonesty offence
- FIAA or Accredited Member
- 5 years’ relevant experience
- Ordinarily resident in Australia
- Some exclusions eg. Employee of auditor or trustee
- Assess before appointment and annually
- Trustee must make reasonable enquiries to assess F&P
- Effective 1 July 2013
- Notifications to APRA required

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SPS 521-Conflicts of Interest (COIs)

- Trustee must have conflicts management policy
- Roles/actions to assess, monitor, avoid or manage COIs
- Regular & thorough enquiry of service providers
- Applies to appointed actuary as a ‘responsible person’
- Requires register of ‘relevant interests’ that may significantly influence RP’s capacity to act in members’ best interests
- Actuaries will need to disclose any relevant duties and interests which may result in actual or potential COI
- Public disclosure of register not required

SPS 114: Overview

SPS 114 Operational Risk Financial Requirement

Objective

The Trustee must maintain adequate financial resources to address losses arising from operational risks within its business operations – Operational Risk Financial requirement (ORFR)

Operational Risk

- Trustee sets own ORFR taking into account business size, complexity and mix
- ORFR must be sufficient to cover both identified risks, and risks not specifically identified in risk management framework
- Trustee must determine a tolerance limit, below which must take action to replenish reserves over a ‘reasonable’ period
- ORFR may be held as Trustee capital or as a risk reserve (inside the fund)

ORFR Strategy

Must describe (among other things):

- Factors influencing the size of the reserve and tolerance limit
- Investment strategy for reserve
- Process for how and when reserves will be called upon
- Process for implementing a replenishment plan if tolerance level is breached
- Process for monitoring and reviewing adequacy

Implementation

- Reserves must be built within 3 years
- Must develop a transition plan, including:
  - How the reserves will be built
  - Expected date to meet the requirement

Other Matters

- For public offer funds, requirement replaces existing trustee capital requirements
- Reserve may only be called upon to address losses from operational risk
- ORFR and tolerance limit must be reviewed annually
- Trustee must have a process for implementing appropriate internal and external audit review
- APRA can require an external expert review

SPS 114: IAAust Submission / APRA Response

IAAust suggestions:

- Clarity regarding interaction between multiple reserves
- Clarity of Op Risk definition
- Strategy to be required to explicitly include how “unfettered access” will be managed, particularly in times of stress
- FCRs play a useful role in Board reporting of the integrated adequacy of reserves – PPG
- Recognise need for future projections and scenarios for replenishment plans - PPG

APRA amendments:

- Clarify that it may be appropriate at times to reduce the size of the ORFR

SPS 114: Key Challenges

- Approach to determination of ORFR amount
  - Modelling / scenarios / rule of thumb
  - Data availability
- How to link to Risk Appetite
  - Target ORFR
  - Tolerance Level
- Reaching 25bps on narrow Op Risk definition
- APRA expectations are unclear:
  - Variation in target for funds of varying complexity
  - Tolerance level
  - Interpretation of Op Risk definition
    - “Deprived of a gain”?

SPS 220: Overview

SPS 220
Risk Management

Objective

The Trustee must have in place systems for identifying, assessing, managing, mitigating and monitoring material risks that may affect its ability to meet its obligations to beneficiaries

Risk management Framework

Trustee must have a Risk Management Framework:

- Risk Appetite Statement
- Risk Management Strategy
- Dedicated Risk management function

Business Plan

- Aligned with the risk management framework
- One to five year rolling plan
- Annual review

Risk Appetite Statement

Articulates:

- Degree of risk willing to accept
- Risk tolerance: Maximum level of acceptable residual risk for each material risk
- Process for ensuring risk tolerances are appropriate
- Process for monitoring compliance with risk tolerances
- Timing and process for review

Risk Management Strategy

Must describe:

- Each material risk, and the approach to management
- Process for identifying and assessing risks and controls
- Process for establishing, implementing and testing mitigation and control mechanisms
- Monitoring, communicating, reporting risk issues, including escalation procedures
- Roles and responsibilities within Board and Staff

Other matters

Risk Management Function

- Development and maintenance of framework
- Functionally independent from business units
- Appropriate experience and qualifications
- Necessary authority and reporting structure

Board must complete a risk management declaration on an annual basis

SPS 220: IAAust Submission / APRA Response

IAAust suggestions:

- Concept of ICAAP within LPS 220 and GPS 220 reinforces holistic nature of risk management
  - Suggest SPS 220 discuss integration of risk management framework and financial resources (i.e. reserves / capital)
  - In future, consider an ICAAP-type concept for superannuation

APRA response:

- Business plan – amended requirement from a rolling three year plan, to a plan of between one and five years
- Some submissions suggested stress testing in place of risk tolerances – APRA has not amended the SPS in this respect, recognising the importance of risk tolerances in monitoring risk

SPS 220: Key Challenges

- Articulation of Risk Appetite
  - New concept for many
- Determination of risk tolerances
  - Valuable exercise
- Establishing the Risk Management Function
  - Insufficient expertise in-house
  - Additional cost of outsourcing
- Considering risk, and supporting capital, in a holistic manner
  - Restricted capital usage for sub-set of operational risks
  - What about other risks?

SPS 530: Overview

SPS 530 Investment Governance	Objective
	Implementation of a sound investment governance framework involving the development of articulated investment strategies, and the selection, management and monitoring of investments

Inv. Governance Framework

Includes:
- Objectives for each option
- Strategy for the plan and for each option
- Policies relating to investment activities
- Role statements related to investment activities
- Structures, policies, processes for performance and risk measurement, assessment, reporting
- Review processes

Investment Strategy

- Document how have regard to SIS 52(6)
- Requirements for considering diversification
- Determine stress scenarios, and test prior to implementation
- Asset allocation targets and ranges
- Rebalancing policy
- Additional requirements for MySuper option
- Documented inv. selection process, due diligence

Liquidity

Must have a liquidity management plan for each investment option, including
- Procedures for measuring and managing liquidity
- Management of liquidity under stress scenarios
- Identification of significantly adverse liquidity outcomes (liquidity events)
- Action when a liquidity event occurs

Other Matters

- Persons responsible for monitoring must not be those responsible for implementation
- Objectives and monitoring must include both risk and return measures
- Senior management and Board must see the regular stress testing reporting and liquidity scenario monitoring

SPS 530: IAAust Submission / APRA Response

- Support for stress testing (as part of Financial Condition Report)
  - Suggested the PPG make reference to the Institute's practice guideline
- Paragraph 17(a) requires stress tests for events that "create extraordinary losses" and "make control of the risk in the investment strategy difficult"
  - Suggested the addition of scenarios that give rise to a "liquidity event"
  - Suggested that some indication of probability would be useful in the PPG
- Suggested that a "liquidity event" should constitute the fund being in an "unsatisfactory financial position" for the purposes of section 133 (suspension of a trustee) and section 263 (investigation by regulator)
  - To be exercised only in severe cases

APRA response:

- APRA has not amended the SPS in this respect – PPG yet to be released

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SPS 530: Key Challenges

- Investment reporting measures will require significant additional work for funds with a large number of choice products
  - APRA will provide further guidance in the PPG
- The investment governance framework has been amended so that trustees only have to manage and monitor all *identified* sources of investment risk
- To ensure the robustness and integrity of the investment governance framework, persons responsible for assessing investment performance must be *operationally independent* from persons responsible for implementation
- APRA has confirmed that it is appropriate for trustee’s to establish a policy to monitor and manage the asset allocation within determined ranges
  - This does not specifically have to be a rebalancing policy
  - But there does need to be a basis for which changes can be made to asset allocation targets and ranges