



EXPLANATORY MEMORANDUM TO PRACTICE GUIDELINE 499.05 (FINANCIAL CONDITION REPORTING FOR SUPERANNUATION FUNDS)

June 2012

A. About this Explanatory Memorandum

This Explanatory Memorandum has been prepared by the Superannuation Risk Management and Financial Condition Report (FCR) Task Force ("Taskforce") on behalf of the Superannuation Practice Committee ("SPC") to assist Members in understanding the new Practice Guideline 499.05 (Financial Condition Reporting for Superannuation Funds) ("PG 499.05").

B. Application of Practice Guideline

PG 499.05 applies to Members preparing information, analysis or advice regarding the financial condition of a superannuation fund (including defined benefit and accumulation funds, and pension divisions).

PG 499.05 does not apply to the particular requirements for an actuarial investigation of a defined benefit superannuation fund required under SIS Regulation 9.5 (which are covered by Professional Standard 400 (Investigations of the Financial Condition of Defined Benefit Superannuation Funds)) or any other legislative or regulatory requirements covered by other Professional Standards or Practice Guidelines.

C. Background to the development of the Practice Guideline

Following a presentation at the Institute's 2010 Financial Services Forum, the Taskforce was established with the goal of improving the financial and risk management of superannuation funds.

The Taskforce consulted widely (presenting at different industry forums) on the topic of financial condition reports ("FCR") for superannuation funds, including presenting a concurrent session at the Institute's 2011 Biennial convention discussing the value proposition for FCRs (and releasing survey results of industry funds in relation to risk management and the perceived value of the different components of an FCR).

Concurrently, the reforms proposed by the Australian Government in 2011 as part of the Stronger Super Reform package included a number of items requiring the trustees of superannuation funds to have particular regard to many of the matters covered by an FCR. The requirements are to be specified in APRA prudential standards. The Taskforce was represented in Treasury's Stronger Super consultation process (in respect of the governance aspects of the reforms) and contributed to Institute submissions to APRA on the operational risk financial requirement.

The proposed reforms include (amongst other matters) requirements:

- ▶ for APRA-regulated superannuation funds to hold financial resources in the form of an operational risk reserve (or capital). The size of these operational risk reserves (or capital) is to be determined by the fund's trustee based on the operational risk exposure of the fund;
- ▶ for the trustee directors to examine and attest whether their Mysuper products (as defined in the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 (Cth)) have sufficient scale with direct implications to test fund sustainability;
- ▶ in relation to the development of risk appetite statements; and
- ▶ for the conducting of stress testing.

It is considered that FCRs can play an important role in relation to these and other elements of the proposed prudential standards, providing both a methodology for the trustee and a clear demonstration as to how they reached their conclusion.

In addition to the use of an FCR in relation to Stronger Super, it is considered that the matters to be covered by an FCR (as set out in the Practice Guideline) will also provide valuable information in relation to the general best practice management of superannuation funds.

D. Consultation undertaken

A Discussion Draft of the proposed Practice Guideline was issued in October 2011 for comment and presentations thereon given to Members at the Institute's Super Policy Forum events held in October and November 2011. Members were also invited to provide written feedback on the Discussion Draft and feedback was sought from, and provided by, APRA. Six submissions from members were received and taken into account, as well as the feedback from the Super Policy Forums and APRA.

E. Changes since the Discussion Draft

To recap, the Discussion Draft of PG 499.05 encompassed an FCR which would provide:

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- ▶ an objective assessment of the financial condition of a fund, now and in the future;
- ▶ an assessment of Material risks facing the fund, now and in the future; and
- ▶ an objective assessment of the adequacy of the fund's reserves including any operational risk reserve and the process for utilising and replenishing those reserves.

The Discussion Draft of PG 499.05 also provided for the scope of a full FCR to include:

- ▶ a financial strength assessment (financial condition at the date of review);
- ▶ a fund sustainability assessment (expected financial condition in the future);
- ▶ an actuarial risk review (adequacy and suitability of the risk management framework); and
- ▶ stress testing (adverse experience, for example liquidity, unit pricing, other).

Following feedback on the Discussion Draft of PG 499.05, the following changes were made and reflected in the final of PG 499.05:

- ▶ updating of references to legislation and APRA Prudential Standards (to reflect ongoing developments);
- ▶ inclusion of a reference to the Code of Professional Conduct in respect of the actuarial risk review (in relation to areas of the review where the Member may not be an expert);
- ▶ expanding the section concerning fund member expectations / guarantees; and
- ▶ additional reference to death and disability experience.

F. Commencement date

PG 499.05 commences on 1 July 2012.

END OF EXPLANATORY MEMORANDUM