17 March 2023

General Manager
Policy
Australian Prudential Regulation Authority

Via email: superannuation.policy@apra.gov.au

Dear Sir/Madam

Discussion paper: Financial resources for risk events in superannuation (the "discussion paper")

Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia welcome the opportunity to provide comments on the discussion paper.

CPA Australia and CA ANZ represent over 300,000 professional accountants globally. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

Registrable Superannuation Entity (RSE) licensees have statutory and common law obligations to manage operational risks in a fair and prudent manner. To do so, they must have access to financial resources to address the impacts of these risks. Since 2013, *Prudential Standard SPS 114 Operational Risk Financial Requirement* (SPS 114) has required RSE licensees to maintain financial resources for operational risks while spreading the impact fairly across members. However, due to industry changes and feedback received, the Australian Prudential Regulation Authority (APRA) plans to replace SPS 114 with new requirements.

The new requirements will replace the existing Operational Risk Financial Requirement (ORFR) with a two-tiered model: The first part will ensure that RSE licensees have access to financial resources to fund recovery or exit activities. The second part will address operational risks and distribute the impact of such risks fairly across various member groups. This component will be similar to the current ORFR, but will allow more flexibility.

We note that the proposed changes will affect auditors, as the ORFR needs to be audited each year. The changes proposed in the discussion paper are very likely to affect existing audit procedures. This should be discussed with the audit profession prior to implementation.

Additionally, we note that there are a number of new variables which are to be combined into the new ORFR. These are likely to require extensive changes to existing reporting, risk, audit, and administration processes currently in use by trustees.

Our detailed responses to some of the questions contained in the discussion paper are provided in the attachment to this letter.

For further information in relation to our submission, please contact Richard Webb, Policy Advisor Financial Planning and Superannuation at CPA Australia at richard.webb@cpaaustralia.com.au or Tony Negline, Superannuation Leader at CA ANZ at Tony.Negline@charteredaccountantsanz.com .

Yours sincerely

Tony Negline CA	**Richard Webb**
Superannuation and Financial Services Leader,	**Policy Advisor Financial Planning and Superannuation,**
Chartered Accountants Australia and New Zealand	**CPA Australia**

Attachment

Submission

Responses to questions

CA ANZ and CPA Australia provide the following in response to the questions contained in this discussion paper. Note that we have chosen not to respond to all questions.

Baseline+ model

1. What changes, if any, would enhance the proposed scope of permitted use for the baseline component and for the operational risk component?

We do not propose additional enhancements to this component. However, we consider that the requirement to ensure that the reserve components are subject to different investment objectives is likely to affect processes in place either within RSEs, or those in place at RSE licensees (depending on how the reserve is intended to be administered). These processes will necessarily range upwards from base level procedures to a fund's investment strategy. These may be expensive processes to implement.

2. What legal or practical restrictions may impede RSE licensees from implementing or complying with the proposed Baseline+ model?

Ensuring that different components of the reserve are invested separately may require new processes. Each RSE will make their own decisions, but we believe it may be simpler for funds to consider the reserve components as separate reserves for reporting, risk, audit and administration purposes, as the components are designed for different purposes.

3. Are there any likely unintended consequences of the model or individual proposed requirements?

We note that the proposed enhancements to the baseline component will permit RSE licensees to use one of two methods to calculate this component, with the basic calculation method providing a basic minimum set by a formula depending on the number of members and a minimum dollar amount. However, the operational risk amount would not, as APRA plans to remove this guidance from *Prudential Practice Guide SPG 114 Operational Risk Financial Requirement* (SPG 114).

While we share APRA's concerns that funds may have been "over-reserving", we note that the presence of a guide amount is often used by funds as the ideal that should be followed.

We offer no comment in this question about whether the presence of a guide amount leads funds to "under-reserve" via technical breaches, or whether a requirement for funds to self-assess leads funds to under-reserve due to setting policy target amounts too low.

Baseline component

4. Will RSE licensees likely have sufficient capability to calculate the proposed baseline component, and what methodology would be used?

We offer no response to this question.

5. What is the likely level of the baseline component?

We offer no response to this question.

6. How often should the baseline amount be reviewed and why?

We note that existing reserving policy is already addressed by funds, and consider that the current framework used by funds should be sufficient for assessing the baseline amount.

7. What are your views on providing a basic calculation option, with the amount held linked to member numbers? Are there any other methods that would be more efficient or better targeted?

We consider that trustees are likely to view a basic calculation method as a guide. However, as indicated in our response to Question 3, we offer no comment on the risk of under-reserving, since risks which are presently addressed by trustees are varied. Consequently, depending on the risk being mitigated – for example, unit pricing errors, cyber-risks, regulatory risk etc. – there are likely to be a number of differing ideas about the appropriate reserve amount.

We also note that the baseline component is designed to have a narrow scope. Consequently, a sensible calculation method should be capable of being used by most of the sector, and regularly reviewed as to its appropriateness.

8. Should APRA set a minimum amount for the baseline component or would this lead to unintended consequences?

We consider that a basic calculation option will, for many funds, imply a minimum amount. A way to ensure that this option is not perceived as the preferred option might be for APRA to adopt messaging in the replacement to SPG 114 that this not to be considered as a 'default'.

Operational risk component

9. Would RSE licensees have the capability to determine an appropriate target amount for the operational risk component?

We consider that RSE licensees should be able to provide an estimate of past experience, combined with upper and lower bounds. Where new risks are being considered, outside experts may need to be consulted to ensure that this is integrated into any new target amounts.

10. What controls may be necessary to address the risk that the target amount is not efficient or not prudent (too high or too low)?

We offer no response to this question.

11. How should a maximum timeframe for the replenishment of the operational risk component to its target amount be set?

As previously noted, existing reserving policy is already addressed by funds, and we consider that the current framework used by funds should be sufficient for assessing the appropriate timeframe for replenishment. In our view, replenishment should already be considered by trustees as part of an RSE's existing reserving policy.