Law Council
OF AUSTRALIA

Legal Practice Section

13 May 2024

Mr Gideon Holland
General Manager, Policy
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2001

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

Dear Mr Holland,

Consultation on financial resources for risk events in superannuation: Operational risk financial requirement

1. This submission has been prepared by the Superannuation Law Committee of the Law Council of Australia's Legal Practice Section (the **Committee**). The Committee welcomes the opportunity to make a submission to the Australian Prudential Regulation Authority (**APRA**) about the draft amendments to Prudential Standard SPS 114—Financial Resources for Operational Risk (**SPS 114**) and Prudential Practice Guide SPG 114—Operational Risk Financial Requirement (**SPG 114**).

2. The Committee acknowledges that registrable superannuation entities (**RSE**) licensees need to ensure they have ready access to financial resources to respond to, and rectify, the impacts of operational risks.

3. The Committee provided its response to APRA's Discussion Paper—*Strengthening Financial Resilience in Superannuation* in its submission dated 18 March 2022.

4. The Committee notes that, having considered industry feedback, APRA will not progress the proposal to introduce separate components to the Operational Risk Financial Requirement (**ORFR**). Instead, APRA's simpler approach is focused on integration with CPS 230 and better enabling use of the ORFR financial resources when needed.

Proposed Amendments to SPS 114

Authority

1. Paragraph 1 of draft amended SPS 114 states that the Prudential Standard is made under section 34C of the Superannuation Industry (Supervision) Act 1993 (**SIS Act**) (as is usual), but proposes to insert the additional words "and pursuant to section 52(8)(b)".

2. Section 52 provides for covenants to be implied into the governing rules of RSEs: see section 52(1). Subparagraph (8)(b) provides that the covenants referred to in subsection (1) include a covenant by each trustee of the entity "*to maintain and manage in accordance with the prudential standards financial resources (whether capital of the trustee, a reserve of the entity or both) to cover the operational risk that relates to the entity"*.

3. Unlike section 34C, section 52 is not a rule-making power. The Committee submits that reference to section 52 is not appropriate as a source of authority for the making of the amended SPS 114.

4. If APRA identifies a need to specify a relevant prudential matter, it should do so by reference to one or more paragraphs in subsection (4) of section 34C, i.e. subparagraph (4)(a)(i) ("the *conduct by an RSE licensee … in such a way as to … protect the interests of the beneficiaries of the registrable superannuation entity*") and/or subparagraph (4)(c)(i) ("*the conduct by an RSE licensee … in such a way as … to keep itself in a sound financial position"*).

5. If APRA considers it helpful to reference section 52(8)(b), it could alternatively use the words "and having regard to the trustee covenant set out in section 52(8)(b)".

Previous exercise of discretion

6. Paragraph 5 of draft amended SPS 114 does not appear to provide for an automatic continuance of a previous exercise of discretion by APRA under a previous version of SPS 114. It is not clear why that is the case.

7. In referring to a new requirement on an RSE licensee to contact APRA before it seeks to "*place reliance on*" a previous exercise of discretion, it appears that APRA accepts that, without more, that discretion does continue, at least absent revocation by APRA.

8. Paragraph 5 should specify the basis upon which APRA will exercise its discretion to revoke or continue the exercise of discretion.

9. APRA should also specify whether the matters specified in new paragraph 6 (Adjustments and exclusions) are relevant matters that an RSE should address when contacting APRA.

ORFR strategy objectives

10. Sub-paragraphs 9(a) and 12(a) of draft amended SPS 114 introduce the concept of "*the ORFR strategy objectives*".

11. It is not clear what objectives APRA is contemplating. It is not clear whether these are intended to simply reflect the overarching purpose of SPS 114—maintaining adequate financial resources to address losses from operational risks that may affect RSE licensees within its business operations—or something additional, or different.

12. Previously, SPS 114 expressly referred to the "*Objectives and key requirements*" of this prudential standard, however this section has been deleted.

Use of ORFR financial resources

13. The parameters of sub-paragraph 15(a) lack clarity as to the incidents and circumstances that the ORFR can be used for the "remediation of material weaknesses and maintenance of critical operations" in relation to CPS 230. It could be implied that the ORFR can be used to fund uplift required by CPS 230 (without a specific operational risk event having occurred).

14. The Committee recommends that APRA specifically clarify whether an incident that "causes" loss to members is required, or simply that the ORFR can be used for an operational risk that may cause loss in the future (without the need for a trigger incident or event).

Confidence of availability of ORFR financial resources

15. Sub-paragraph 16(b) of draft amended SPS 114 substitutes the previous standard of "*an unrestricted commitment of financial resources*" with "*confidence that the ORFR financial resources will be available when needed to address operational risks*".

16. The change in language introduces an opacity and uncertainty into the prudential standard.

17. The term "confidence" is not used within the SIS Act.

18. It is not apparent whether the revised language proposed in sub-paragraph 16(b) is intended to refer to a particular state of mind and, if so, whose state of mind that would be (the RSE, APRA, a member or beneficiary, or the public).

19. The Committee notes that draft amended SPG 114 also refers to "confidence" in terms that the ORFR "*is intended to provide members with confidence that there is a low risk that the RSE licensee will have insufficient available financial resources …*"

20. It is also not apparent whether a particular measure of confidence is contemplated and, if so, what that measure is, and how it is to be assessed, and by whom.

Review of target amount and tolerance limit

21. Paragraph 21 of the draft amended SPS 114 specifies that an RSE licensee must review the appropriateness of its ORFR target amount "at least annually and following a material operational risk incident or material change to the RSE licensee's business operations".

22. The Committee queries the burden placed on RSE licensees by the proposed introduction of a mandatory review following every material operational risk incident, with no discretion provided to the trustee, or guidance as to the materiality thresholds to be applied, particularly in circumstances where the very purpose of the ORFR financial resources is to meet material operational risk incidents and where there is a standing requirement for an annual review.

23. There is ambiguity in the standard insofar as it does not specify when the review is triggered by each material operational risk incident. For example, it is unclear whether this is when it is discovered, when the material operational risk incident is resolved, or when the RSE licensee has recourse to the ORFR financial resources.

24. Further, the Committee observes that RSE licensees may elect to meet operational risk incidents (including material incidents) from resources other than the ORFR reserve. APRA acknowledges in paragraph 5 of draft amended SPG 114 that RSE licensees may have access to alternative sources of funding to address operational risk incidents such as other regulatory financial requirements, insurance arrangements or financial commitments from a party external to the RSE licensee's business operations.

Proposed Amendments to SPG 114

25. The Committee submits that guidance should be given by APRA as to its expectations concerning the scope and meaning of the "ORFR strategy objectives" in subparagraphs 9(a) and 12(a) of draft amended SPS 114.

26. The Committee notes that paragraph 18 of draft amended SPG 114 maintains the previous language, which states that the "*primary purpose of an operational risk reserve is to provide an unrestricted commitment of financial resources to address losses arising from operational risk events in a timely manner*". However, that purpose is omitted from draft amended SPS 114.

27. Further, having regard to its submission above, guidance should be considered for inclusion as to the proposed new standard of "*confidence*" introduced by sub-paragraph 16(b) of draft amended SPS 114, if it differs from the concept of having a particular belief in a state of existence that there is an unrestricted commitment.

28. Finally, the Committee submits that additional guidance should be given as to the timing of any review that is not an annual review (discovery, resolution, or upon recourse to ORFR financial resources).

29. The Committee would welcome the opportunity to discuss its submission further and to provide additional information about the comments made above. In the first instance, please contact Joanne Dwyer, Chair, Superannuation Law Committee, [redacted].

Yours sincerely



Geoff Provis
Section Chair