

13 October 2023

Gideon Holland
General Manager – Policy
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2001
Australia

Dear Mr Holland,

RE: Prudential Practice Guide Draft CPG230: Operational Risk Management

The Financial Services Council (**FSC**) welcomes the opportunity to provide comment in relation to the draft Prudential Practice Guide CPG230: Operational Risk Management (**the Guidance**). The FSC also made comment in relation to the drafted prudential standard CPS230: Operational Risk Management (**the Standard**) and thanks APRA for its careful consideration of recommendations made during that consultation process, particularly in relation to the implementation timeframes.

The FSC believes that while the Guidance goes some way to clarifying the expectations of APRA in relation to managing operational risk, there are many areas where further guidance is required. This relates to matters such as board oversight, scenario planning, and material operational risk incidents. While FSC members understand that APRA are trying to approach prudential supervision in a flexible way by allowing regulated entities to make decision as to the most appropriate approach to compliance for themselves, this can lead to significant confusion and an inconsistent approach across industry. This may lead to poor customer outcomes in the long run.

FSC members would also like further clarity in relation to the implementation, monitoring, and enforcement of the Standard. Specifically, members would like further information on how compliance with the Standard will be monitored and how implementation milestones will be measured.

About the Financial Services Council

The FSC is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services. Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, and financial advice licensees.

The financial services industry is responsible for investing more than \$3 trillion on behalf of over 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is one of the largest pools of managed funds in the world.

Summary of Recommendations

1. APRA provide clarity in relation to the use of the terms “sound practice”, “best practice” and “better practice” throughout the Standard. Will regulated entities be expected to meet the “better practice” guidance in order to demonstrate compliance with the Standard and if so, this should just be considered the guidance, rather than having separate notions of “guidance” and “sound practice”, “best practice” or “better practice”. APRA provide guidance as to how it will determine whether there is a material weakness in the entity’s operational risk framework.
2. APRA provide guidance as to how it will determine whether there is a material weakness in the entity’s operational risk framework.
3. APRA provide clarity as to the operation of CPS230 Paragraph 19c in relation to SPS114: Operational Risk Financial Requirement and ensure that there is no inconsistency between the operation and powers conferred in both standards as well as no additional burden for superannuation funds.
4. APRA provide clarity as to whether the expectations of the Board outlined in both the Standard and the Guidance are expected to be carried out by the full board or if it is appropriate for the oversight to be conducted by a Committee of the Board which contains appropriate Board representatives and which is required to report up to the full Board on its activities.
5. APRA provide clarity as to whether a significant weakness that the Board should, under the Guidance, deep dive into, is the same as a material weakness as per paragraph 10 of the Guidance. If these are distinct concepts, further clarity is required as to the definition of significant weakness.
6. APRA insert the appropriate definition for Accountable Persons into the Guidance as per the relevant legislative framework.
7. APRA provide clearer guidance in relation to expected practice for scenario analysis as it relates to assessing an entities operational risk profile. This includes the nature of the scenarios i.e whether they need only be thought exercises or full simulations, and how often this process should be undertaken.
8. APRA provide clarity as to whether references to severe operational events and severe but plausible operational events should be taken to mean the same thing or if different scenario analysis is required.
9. APRA provide further guidance in relation to the definition of near miss as it relates to operational risk incidents.
10. APRA provide further guidance in relation to the reporting of material operational risk events including exactly when the 72-hour clock starts. The FSC submits that this should occur when the materiality of an operational incident is determined.
11. APRA provide further guidance in relation to the 72-hour clock, if it encompasses weekends and public holidays, as well as guidance around the determination of materiality as it relates to operational risk incidents.
12. APRA align the wording of Table 1 with regard to operational risk incidents to the Standard to ensure consistency and clarity.

13. APRA provide guidance about how entities are to report on material operational risk incidents.
14. APRA provide further guidance in relation to the definition of material adverse impact to ensure consistency of application across regulated entities.
15. APRA provide further guidance in relation to whether all processes under an operational umbrella such as fund administration must be considered critical or if it is the individual processes that are considered critical.
16. APRA provide clearer guidance as to the meaning of “manage” with regard to fourth parties and other further downstream parties as well as outline its expectations in relation to what ‘assurances’ from a material service provider should look like to satisfy this requirement.
17. Further guidance is required in relation to the minimum list of material service providers contained within the Standard. Specifically in what circumstances those material service providers actual apply to regulated entities.
18. APRA provide certainty to members as to any transitional arrangements to be put in place should it deem appropriate to declare a service provider material for a regulated entity or a class of regulated entities.
19. Further guidance is required in relation to the due diligence in the selection of material service providers where no such process is undertaken because the service is provided by the parent organisation or other related party.
20. APRA provide clarity in relation to the meaning of concentration risk as it pertains to conducting due diligence of material service providers under paragraph 53 of the Standard.
21. APRA provide clarity in relation to the meaning of materially as it pertains to modifying or changing material service provider arrangements.
22. APRA assist industry by briefing some of the larger known service providers with regard to the expectations being placed on regulated entities so that those service providers are prepared and better understand why APRA regulated entities are seeking detailed information with regard to their risk management frameworks including their own third-party risk management.
23. If APRA is not of a mind to brief larger, well known service providers, APRA should provide appropriate support to RSEs to assist them in their communication with material service providers.
24. APRA provide guidance as to how it expects entities should manage Material Service Providers or the third parties who refuse to provide information in relation to the Standards required agreements.
25. APRA provide guidance with regard to RSEs who are in the process of being dissolved due to merger and acquisition activity.
26. APRA provide guidance with regard to whether an RSE Licensee must conduct new due diligence activities in relation to material service providers when an RSE is acquired through a merger process, or if the due diligence conducted by the previous Licensee is sufficient.

27. APRA publish an engagement agenda outlining when and how entities can expect to hear from the APRA supervision team to create a consistent understanding of engagement and implementation expectations.
28. Clarity is sought in relation to the implementation expectations of APRA. Specifically how will implementation readiness be assessed and if there will be enforcement action if an entity is deemed not at the appropriate level of readiness.
29. APRA pre-publish any expected monitoring and enforcement activity plans, including any control objectives to ensure maximum compliance uplift.

The General Nature of Guidance

FSC members are concerned about the general nature of the guidance provided. The FSC acknowledges that APRA's approach to prudential supervision allows regulated entities to make decisions about how to comply with prudential standards in a way that is most appropriate to them, however, there are concerns that this means that although entities will comply in the way that reflects their best interpretation of the Standard, it may ultimately fall short of APRA's expectations or better practice.

There are a few areas specifically, that FSC members would like to see greater clarity and guidance, and these are outlined below.

Areas Where Further Guidance is Warranted

Guidance, Sound Practice, Best Practice, and Better Practice

Clarity is sought in relation to the meaning of the phrase "better practice" as well as "sound practice" and "best practice". Throughout the guidance, general guidance is provided, and this is sometimes followed by guidance that is termed either sound, best, or better practice. The FSC submits that this is confusing as the Guidance should, theoretically, lay out APRA's expectations with regard to complying with the Standard, which should be best practice. Clarity is sought whether APRA will determine compliance with the Standard using the general Guidance or the sound, best, or better practice standard.

Recommendation 1

APRA provide clarity in relation to the use of the terms "sound practice", "best practice" and "better practice" throughout the Standard. Will regulated entities be expected to meet the "better practice" guidance in order to demonstrate compliance with the Standard and if so, this should just be considered the guidance, rather than having separate notions of "guidance" and "sound practice", "best practice" or "better practice".

Material Weaknesses

Paragraph 19 of the Standard gives the power to APRA to require independent review and remediation of operational risk frameworks where it identifies a material weakness. Additionally, in paragraph 10 of the Guidance, it notes that an entity should notify APRA where it identifies that there is a material weakness in its operational risk management.

FSC members would like further clarity in relation to how it will determine what a material weakness is, for example will this be determined in reference to the entity's personal risk appetite (as per paragraph 10 of the Guidance) or will it be in reference to what APRA feels is an appropriate risk appetite for the entity.

Recommendation 2

APRA provide guidance as to how it will determine whether there is a material weakness in the entity's operational risk framework.

Paragraph 19c of the Standard states that APRA may require the entity to hold additional capital where a material weakness in the operational risk management framework is identified. In addition to requiring clarity about how material weaknesses are to be defined, FSC members would also like clarity in relation to how this paragraph interacts with the requirement for operational risk financing under Prudential Standard SPS 114: Operational Risk Financial Requirement.

SPS114 requires RSEs to have funds set aside for the purpose of funding operational risk incidents. Clarity is sought about how this is to interact with the CPS230 Standard. Given superannuation funds are already required to have separate funding for operational risk incidents, the FSC submits that there should not be any duplication of requirements or powers, nor any inconsistency between the two standards.

Recommendation 3

APRA provide clarity as to the operation of CPS230 Paragraph 19c in relation to SPS114: Operational Risk Financial Requirement and ensure that there is no inconsistency between the operation and powers conferred in both standards as well as no additional burden for superannuation funds.

Board Committee Involvement

The Standard makes clear that the governing body of an RSE is ultimately responsible for the oversight of operational risk. The FSC notes the clear guidance provided relating to how a Board might exercise its duties. For example paragraph 16 outlines how the Board might provide effective oversight. However, clarity is sought as to whether it is appropriate for this responsibility to be delegated to a Board Committee that ultimately reports to the Board or whether the full board must do the tasks outlined.

In most businesses a Board Committee made up of Board members as well as appropriate executive staff would be formed for the purpose of managing detailed Board work on specific issues. In some instances, an entity might find it appropriate to delegate the bulk of the Board's work in relation to the Standard to a sub-committee for fulsome consideration. Governance structures usually dictate that such sub-committees report to the Board on their work.

The FSC acknowledges the reasoning for wanting strong Board oversight, however, it may be the case that Board sub committees may have more bandwidth to properly consider the issue of operational risk than the entire Board. This would actually allow for more complete oversight and more thorough consideration of any issues identified.

The FSC recommends further guidance as to whether this is an acceptable approach to Board oversight.

Recommendation 4

APRA provide clarity as to whether the expectations of the Board outlined in both the Standard and the Guidance are expected to be carried out by the full board or if it is appropriate for the oversight to be conducted by a Committee of the Board which contains appropriate Board representatives and which is required to report up to the full Board.

Paragraph 16c of the Guide recommends that Boards deep dive into any areas of significant weakness. Guidance is sought in relation to how significant weakness might be defined and whether there is a distinction between a significant weakness and a material weakness, as outlined above. That is, would a significant weakness that is identified and investigated by the Board be the same as a material weakness that needs to be reported to APRA under paragraph 10.

Recommendation 5

APRA provide clarity as to whether a significant weakness that the Board should, under the Guidance, deep dive into, is the same as a material weakness as per paragraph 10 of the Guidance. If these are distinct concepts, further clarity is required as to the definition of significant weakness.

Accountable Persons

The Guidance makes several references to 'Accountable Persons'. The FSC understands that this has reference to both the Banking Executive Accountability Regime and the recently passed Financial Accountability Regime Bill. The FSC recommends inserting the appropriate definitions of Accountable Person and/or the reference to the legislation for clarity.

Recommendation 6

APRA insert the appropriate definition for Accountable Persons into the Guidance as per the relevant legislative framework.

Scenario Analysis

Greater clarity is sought regarding scenario analysis. Specifically, what APRA's expectations are in relation to the nature and frequency of scenario analysis. Scenario analysis is required within two parts of the Standard: paragraph 27 and paragraph 43.

Paragraph 27 of the Standard requires an entity to maintain a comprehensive assessment of its operational risk profile. This includes undertaking a scenario analysis to identify and assess the potential impact of severe operational risk events, test its operational resilience, and identify the need for new or amended controls and other mitigation strategies.

The Guidance, from paragraph 37, seeks to articulate expectations in relation to scenario analysis however, further clarity is sought regarding the nature and extent of scenario analysis as well as the number of simulations an entity might be expected to run. This information would help entities better understand how often APRA expects scenario analysis to be undertaken and expectations about the nature of the scenario including who should be involved, whether it should be a simple theoretical thought exercise, a tabletop wargame type scenario, or an actual role-play type simulation, and other matters relating to the nature of the simulation.

Scenario analysis is also required in relation to its business continuity plan (**BCP**) as outlined in paragraphs 43 – 45 of the Standard. This paragraph requires that an entity have a systematic testing program for its BCP that covers all critical operations and includes a business continuity exercise. This exercise is defined to include testing the effectiveness of the entity's BCP and its ability to meet tolerance levels in a range of severe but plausible scenarios. Paragraph 44 of the Standard further provides clarity on the expectations of this scenario. Paragraphs 71 to 79 in the Guidance outline expectations in relation to frequency, outcomes, and reporting.

The FSC recommends that similar guidance be provided in relation to paragraph 27.

Recommendation 7

APRA provide clearer guidance in relation to expected practice for scenario analysis as it relates to assessing an entities operational risk profile. This includes the nature of the scenarios i.e whether they need only be thought exercises or full simulations, and how often this process should be undertaken.

Notwithstanding the above, it should be noted that there is a disparity between what types of scenarios are to be analysed and/or rehearsed between paragraphs 27 and 43/44 of the Standard as well as paragraph 37 of the Guidance. Paragraph 27 requires scenario analysis for severe operational risk events whilst paragraph 43 and 44 of the Standard and paragraph 37 of the Guidance require scenario analysis for severe *but plausible* operational risk events.

Clarity is sought in relation to whether these should be taken to mean the same thing or if Paragraph 27 (which merely states severe operational risk events) requires more thorough scenario planning and thereby include less likely or less plausible events, in addition to those that may be deemed to be severe but plausible.

Recommendation 8

APRA provide clarity as to whether references to severe operational events and severe but plausible operational events should be taken to mean the same thing or if different scenario analysis is required.

Operational Risk Incidents

Paragraph 32 of the Standard requires the recording, escalation, and addressing of near-miss incidents. Further clarity is sought in relation to how near misses may be defined. The United Kingdom regime approaches this with a monetary threshold approach.

Recommendation 9

APRA provide further guidance in relation to the definition of near miss as it relates to operational risk incidents.

Notifying of Breaches

Paragraph 33 of the Standard requires funds to notify APRA no later than 72-hours after becoming aware of a material operational risk incident. Guidance is required as to when the 72-hour clock actually begins.

The Standard states that reporting is required 72-hours following the discovery of an operational issue that is likely to have a material financial impact or a material impact on the ability of the entity to maintain its critical operations. Clarity is sought as to whether the 72-hours begin from the discovery of the operational issue itself, or from when the business determines that it is material. In some instances there may be a delay between the former and the latter.

The FSC submits that the clock should not begin until a matter is determined to be material.

Recommendation 10

APRA provide further guidance in relation to the reporting of material operational risk events including exactly when the 72-hour clock starts. The FSC submits that this should occur when the materiality of an operational incident is determined.

Further, it is not clear whether the 72 hours is to include non-business days so, for example, if an incident is discovered on the Friday, does the entity's 72-hours encompass the following two weekend days, as well as any public holidays that may occur.

Further guidance about how APRA considers the issue of materiality would also be useful, including whether this includes outages affecting global service providers, where the incident has occurred outside Australia. This is to ensure consistent reporting of material operational issues between entities and to ensure entities are meeting APRA's expectations.

Recommendation 11

APRA provide further guidance in relation to the 72-hour clock, if it encompasses weekends and public holidays, as well as guidance around the determination of materiality as it relates to operational risk incidents.

The FSC also notes that *Table 1: notifications to APRA lists* "operational risk incidents" as needing to be reported to APRA "as soon as possible and not later than 72 hours after becoming aware of a material incident". For clarity, the FSC recommends that APRA qualify the left-hand column "operational risk incidents" to read "material operational risk incidents" and the right-hand column "material incident" to read "material operational risk incident" to align with the wording of the Standard so as to avoid confusion.

Inconsistencies in the wording between the Standard and the Guidance creates a risk that someone may read only the Guidance and be left with an incomplete understanding of a regulated entities responsibilities.

Recommendation 12

APRA align the wording of Table 1 with regard to operational risk incidents to the Standard to ensure consistency and clarity.

Guidance is also sought in relation to how APRA expect breach notifications to be communicated, whether this is a standard communication or through a dedicated portal as is the case with ASIC's mandatory breach notification regime.

Recommendation 13

APRA provide guidance about how entities are to report on material operational risk incidents.

Material Adverse Impacts

Further guidance is required as to how funds should approach the definition of 'material adverse impact'.

Paragraph 35 of the Standard requires funds to identify critical operations which are defined as having, if disrupted, 'a material adverse impact'. Paragraph 58 of the Guidance explains that in identifying critical operations, a prudent entity would consider business operations that would have a *direct* and *indirect* material adverse impact on beneficiaries.

Given that material adverse impact is the foundation that underpins the definition of critical operations, the FSC submits that further guidance as to APRA's expectation of how this is determined is warranted.

Although the FSC acknowledges that APRA want to provide entities the space to determine, with regard to their individual size and organisational structure, how best to comply with the Standard, without clear guidance on such an important foundation there may be significantly disparate approaches to compliance from entity to entity.

Recommendation 14

APRA provide further guidance in relation to the definition of material adverse impact to ensure consistency of application across regulated entities.

Defining Critical Operations

Clarity is sought in relation to the definition of critical operations. Paragraph 36 of the Standard outlines the minimum critical operations of an RSE including investment management and fund administration however, Paragraph 35 defines critical operations as a process.

RSEs may draw a distinction between an operation such as fund administration and the processes that underpin said operation like payment of benefits. Individual processes underneath an operation may or may not have material adverse impacts on members and beneficiaries.

Further guidance is required as to whether critical operations apply specifically to the operational umbrella (fund administration) or just the individual processes underneath.

Recommendation 15

APRA provide further guidance in relation to whether all processes under an operational umbrella such as fund administration must be considered critical or if it is the individual processes that are considered critical.

Managing the Risks Associated with Fourth Parties

Paragraphs 47 and 48 of the Standard require an entity to maintain a comprehensive service provider management policy including considering any risks associated with service providers relied upon by said material service providers (i.e fourth parties).

Paragraph 91 of the Guidance notes that entities should do “due diligence” to identify material fourth parties (and even further downstream if possible) and “manage” the risks associated with them.

The FSC submits that this is a very large and sometimes unmanageable expectation. Although there may be some instances where contractual arrangements can be used to ascertain this information, it may not always be reasonable to expect a third party to divulge its own full list of material service providers, especially as many third and fourth parties will not be APRA regulated entities and are under no compulsion to do so. Nor is it necessarily reasonable for the RSE to adequately determine which of those fourth party providers may be material and how it can mitigate the risks associated with them. This is even more true, the further downstream you go.

It should be noted that the guidance does not adequately define what is meant by managing the risks associated with fourth, fifth, or further downstream parties. For example, are entities expected to impose their tolerance levels on material service providers who operate under their own business continuity plans and, may even be subject themselves to CPS230 and therefore have their own critical operations and tolerance levels set.

Further, paragraph 91c of the Guidance states that entities should receive assurances from service providers that they are able to manage material fourth parties. Clarity is sought as to whether receiving this undertaking from a third party wholly satisfies the entities need for downstream risk management, and what form this assurance should take.

Recommendation 16

APRA provide clearer guidance as to the meaning of “manage” with regard to fourth parties and other further downstream parties as well as outline its expectations in relation to what ‘assurances’ from a material service provider should look like to satisfy this requirement.

Material Service Providers

Paragraph 50 of the Standard outlines at a minimum what entities should classify as material service providers. For RSEs this comprises fund administration, custodial services, investment management, and arrangements with promoters and financial planners. The Guidance does not provide guidance in relation to how the materiality of other service providers should be assessed, nor does it provide guidance in relation to the minimum material service providers.

Clarity is sought in relation to the arrangements with financial planners as there are some RSE funds who have relationships with financial planners where the RSE is the recipient of the service, this would naturally seem to be captured by paragraph 50, however, where a fund has a relationship with a financial planner where the customer is the recipient of the service, clarity is required as to whether this would be considered a material service.

Recommendation 17

Further guidance is required in relation to the minimum list of material service providers contained within the Standard. Specifically in what circumstances those material service providers actual apply to regulated entities.

Paragraph 52 of the Standard provides APRA with the power to require a regulated entity or a class of regulated entities to classify a service provider, type of service provider, or service provider arrangement as material. The FSC recommends APRA provide certainty to entities through the guidance that where such a declaration is made, appropriate timelines and transitional arrangements will be granted to allow for uplift and contract re-negotiations. For example, allowing a minimum of 12 months or on the next contract renewal, whichever is longer.

Recommendation 18

APRA provide certainty to members as to any transitional arrangements to be put in place should it deem appropriate to declare a service provider material for a regulated entity or a class of regulated entities.

Paragraph 53 of the Standard outlines expectations with regard to service provider agreements. This includes conducting due diligence and outlining an appropriate selection process. Guidance is required in relation to the treatment of material service providers from a related party such as wholly owned entities in the corporate group in relation to these expectations.

In the case where the parent company of an RSE undertakes these services, it is assumed that no such due diligence will take place.

Clarity is sought as to how APRA will measure compliance in these instances.

Recommendation 19

Further guidance is required in relation to the due diligence in the selection of material service providers where no such process is undertaken because the service is provided by the parent organisation or other related party.

Paragraph 99 of the Guidance notes that, in relation to conducting due diligence under paragraph 53 of the Standard, concentration risk should be taken into account. Further guidance is required in relation to how APRA defines concentration risk. For example, does concentration risk mean at an industry level where a number of RSEs may be using the same provider or at an entity level where the entity has chosen one supplier to provide multiple services.

Recommendation 20

APRA provide clarity in relation to the meaning of concentration risk as it pertains to conducting due diligence of material service providers under paragraph 53 of the Standard.

Materially Modifying a Material Arrangement

Paragraph 53 of the Standard lists tasks an APRA regulated entity must undertake before materially modifying a material arrangement. In addition, paragraph 59 requires entities to notify APRA when a material service provider agreement is materially changed. Clarity is sought in relation to the meaning of materially in these paragraphs. For example, does materially changing mean a change to the nature of the services provided or material changes to the clauses or obligations within the agreement.

Recommendation 21

APRA provide clarity in relation to the meaning of materially as it pertains to modifying or changing material service provider arrangements.

Communication to Material Service Providers

As outlined above, the Standard requires entities to adequately manage the risks associated with their material service providers. It is foreseeable that there will be significant overlap between regulated entities with regard to the use of third-party service providers and those providers in turn will likely use a similar list of fourth party providers.

Whilst it is not reasonable to compile a complete list of these potential providers there are a reasonable number of obvious service providers that would be used across the industry. Some of these providers are large organisations such as Google and Amazon Web Services. FSC member feedback is that sometimes providers can be sceptical with regard to sharing their own risk management plans and, as they are not regulated by the Standard, there can be reluctance to assist regulated entities.

In order to better facilitate the sharing of material risks and fourth party risk management, the FSC recommends that APRA seek to communicate with these known and obvious larger stakeholders the expectations being placed on regulated entities.

This would prepare those material service providers for the contract negotiations that are inevitably coming, including inserting the need to allow for APRA to conduct onsite visits to the service provider, as regulated entities begin to prepare for implementation.

It may be appropriate for this to be done in conjunction with ASIC who may be the regulator for at least some third-party providers.

Recommendation 22

APRA assist industry by briefing some of the larger known service providers with regard to the expectations being placed on regulated entities so that those service providers are prepared and better understand why APRA regulated entities are seeking detailed information with regard to their risk management frameworks including their own third-party risk management.

If APRA is not of a mind to brief these larger known service providers, the FSC asks that APRA provide appropriate support to RSEs to help communicate with these service providers the expectations in relation to the Standard. This could be in the form of a letter from APRA that can be presented to the provider or another form as APRA deems appropriate. This guidance from APRA would help to explain why RSEs are seeking additional information and the consequences if the RSE does not comply with the Standard.

Recommendation 23

If APRA is not of a mind to brief larger, well known service providers, APRA should provide appropriate support to RSEs to assist them in their communication with material service providers.

Notwithstanding the request above for support from APRA in communicating to Material Service Providers, clarity is sought if it eventuates that the entity cannot come to an agreement with a service provider to divulge the required information.

Paragraph 54 of the Standard outlines the minimum requirements for material service provider agreements. This may represent a significant uplift in contractual requirements with service provider organisations.

In some cases, these organisations may be very large providers and it may not be in the best financial interests of members to utilise a smaller, bespoke service where the larger provider is clearly the market leader and has access to the financial benefits of economies of scale.

Recommendation 24

APRA provide guidance as to how it expects entities should manage Material Service Providers or the third parties who refuse to provide information in relation to the Standards required agreements.

Fund Rationalisation

The superannuation industry has seen significant merger and acquisition action in the last several years. As a result, there are a number of RSE Licensee parent companies that are operating multiple RSEs. Some of these RSE Licensees have plans to merge their RSEs into consolidated entities.

This will likely be an ongoing matter as the performance test, best financial interests duty, and general market conditions necessitate the merging of superannuation funds. Therefore, the FSC is seeking clarity in the Guidance about how RSE Licensees should consider their obligations under the Standard where they know an RSE is to be merged and will no longer exist.

This is particularly relevant given APRA have just released a draft Standard and associated Guidance in relation to SPS 515: Strategic and Transfer Planning which requires RSEs to think carefully about how they might enact a successor fund transfer in the event it becomes the most appropriate way to meet the best financial duties test.

Recommendation 25

APRA provide guidance with regard to RSEs who are in the process of being dissolved due to merger and acquisition activity.

Further, where an RSE Licensee acquires an RSE through merger activity, clarity is sought as to whether new due diligence of material service providers is required or if the due diligence conducted by the previous licensee is sufficient.

Recommendation 26

APRA provide guidance with regard to whether an RSE Licensee must conduct new due diligence activities in relation to material service providers when an RSE is acquired through a merger process, or if the due diligence conducted by the previous Licensee is sufficient.

Implementation, Monitoring and Enforcement*Engagement from APRA Supervision Team*

Regulated entities have been told that the APRA supervision team will engage with them directly in relation to implementation expectations. The FSC recommends that APRA publish an engagement agenda in order to ensure consistent understanding across industry about any engagement and implementation expectations.

Further, given there are a number of interrelated prudential compliance matters afoot concurrently, including for prudential standards; CPS190: Recovery and Exit Planning and CPS900: Resolution Planning, clarity as to whether there will be separate approaches, or one single approach from APRA would be beneficial.

Recommendation 27

APRA publish an engagement agenda outlining when and how entities can expect to hear from the APRA supervision team to create a consistent understanding of engagement and implementation expectations.

Implementation Deadlines

The Standard will come into force on the 1st of July 2025 however, in a speech delivered on the 23rd of August 2023, APRA member Therese McCarthy Hockey outlined some expectations on APRA's part in relation to implementation milestones. Specifically, it was stated that APRA would begin "assessing" implementation preparedness within the next six months and outlined some expected deadlines such as having critical operations and material service providers identified by the middle of 2024.

The FSC seeks clarity in relation to how implementation readiness will be assessed and what the consequences of not meeting these expectations will be.

Recommendation 28

Clarity is sought in relation to the implementation expectations of APRA. Specifically how will implementation readiness be assessed and if there will be enforcement action if an entity is deemed not at the appropriate level of readiness.

Monitoring and Enforcement

Clarity is sought from APRA about how entities can expect monitoring of compliance post-implementation will be conducted. For example, can regulated entities expect a tripartite audit process similar to the process being undertaken in relation to CPS234: Information Security. To facilitate that particular audit, auditors are assessing regulated entities against a series of control objectives. It should be noted that these control objectives do not form part of CPS234 or its associated guidance.

If the purpose of the audit is to ensure compliance, the FSC recommends that APRA publish the expected control objectives, either within the Guidance or separately. This will not only ensure that regulated entities can satisfy themselves that they will pass auditing, but also uplift the regulated entity cohort's overall compliance which will ultimately have better outcomes for consumers.

Recommendation 29

APRA pre-publish any expected monitoring and enforcement activity plans, including any control objectives to ensure maximum compliance uplift.

If you would like to discuss anything contained in this submission, please do not hesitate to contact me.

Yours sincerely,

Kirsten Samuels

Policy Manager, Superannuation and Innovation