

## Superannuation (prudential standard) determination No. 2 of 2013

### EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

*Superannuation Industry (Supervision) Act 1993*, subsection 34C(1)

Under subsection 34C(1) of the *Superannuation Industry (Supervision) Act 1993* (the Act), APRA has the power to determine standards (prudential standards), in writing, in relation to prudential matters to be complied with by all RSE licensees of registrable superannuation entities (RSEs).

On 28 June 2013, APRA made Superannuation (prudential standard) determination No. 2 of 2013 under subsection 34C(1) of the Act (the instrument).

The instrument will take effect on 1 July 2013.

#### **1. Background**

The Government indicated, in its response to the recommendations of the Super System Review in December 2010, support for the recommendation that APRA be given the power to make prudential standards in respect of superannuation, consistent with APRA's existing powers in respect of banking and insurance.<sup>1</sup>

In April 2012, APRA released 11 draft prudential standards to implement APRA's proposed prudential framework for superannuation, incorporating those elements of the Government's superannuation reforms that come within APRA's mandate. APRA's proposals covered prudential requirements common to other APRA-regulated industries as well as superannuation-specific requirements. The proposals also included relocating some current requirements in the Act and the *Superannuation Industry (Supervision) Regulations 1994* and non-binding guidance material into the new prudential standards, and harmonising the requirements for superannuation with those applying to other APRA-regulated industries to the extent practical.

On 15 November 2012, APRA determined eight new prudential standards for superannuation after a long consultation process. At the same time, three prudential standards – *Prudential Standard SPS 160 Defined Benefit Matters* (SPS 160), *Prudential Standard SPS 310 Audit and Related Matters* (SPS 310), and *Prudential Standard SPS 520 Fit and Proper* (SPS 520) – were released in proposed final version.

In the response to submissions that accompanied the final prudential standards, APRA indicated that these three standards could not be determined at the time because they each contained provisions that required the passage of the Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Bill 2012 (Tranche 4 Bill). The determination of SPS 160 has also been dependent on amendments to the

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<sup>1</sup> *Stronger Super*, Recommendation 10.2, p. 60.

SIS Regulations. The Tranche 4 Bill received royal assent on 26 June 2013 and the amendments to the SIS Regulations will be made on 1 July 2013.

APRA was granted the ability to make prudential standards in relation to superannuation under the Act by the passage of the *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* on 8 September 2012.

## **2. Purpose and operation of the instrument**

The purpose of the instrument is to make SPS 160, which sets out prudential requirements for the management of defined benefit funds with the objective of enabling the RSE licensee of the fund to meet the liabilities of the fund, out of the assets of the fund, as the liabilities become due.

The key requirements of SPS 160 are that an RSE licensee of a defined benefit fund must:

- appoint an RSE actuary to undertake, and report on, regular actuarial investigations into the financial position of a defined benefit fund;
- arrange for an interim actuarial investigation in circumstances where the financial position of a defined benefit fund deteriorates below a shortfall limit set by the RSE licensee; and
- implement a program to restore a defined benefit fund to a satisfactory financial position, so that the vested benefits of beneficiaries are fully funded, and submit the program to, and report to, APRA.

Other specific requirements relate to:

- application of the prudential standard to defined benefit sub-funds; and
- if the fund is permitted to self-insure benefits, arrangements for regular actuarial oversight, annual attestation that the self-insurance continues to be in the best interests of beneficiaries, and development of a contingency plan for an orderly wind-up of the self-insurance.

## **3. Consultation**

In September 2011, APRA released for public consultation a discussion paper, *Prudential Standards for Superannuation*, which outlined proposals, including the Stronger Super reforms that the Government had recommended APRA implement in prudential standards. A suite of 12 prudential standards, including a standard dealing with defined benefit fund matters, was described in the paper.

APRA received 41 written submissions in response to this discussion paper and held discussions with a variety of industry participants. Submissions on the draft proposals relating to defined benefit matters focussed on issues relevant to the objective of the proposed standard, that is, full funding of members' vested benefits. Submissions commented on the proposal for a restoration plan, including that one should only be

required where there is a persistent, rather than an isolated, shortfall below the vested benefits level. Other topics raised included the duration of a restoration plan, the treatment of defined benefit sub-funds and interaction of the proposed standard with existing regulation of technically insolvent funds.

In a second consultation round, APRA released a *Response to Submissions – Prudential standards for superannuation* (Response) and a package of 11 draft prudential standards, including draft SPS 160, on 27 April 2012. In the Response APRA noted the issues raised in submissions and that it had modified the treatment of certain defined benefit matters in response to submissions. These modifications included:

- a requirement for the RSE licensee to set a limit that would trigger implementation of a restoration plan where a shortfall is identified outside the triennial actuarial investigation with RSE licensees being able to choose to set the trigger point below the level at which vested benefits are fully funded to allow for normal market fluctuations of short duration;
- an outline of the features of a restoration plan, including maximum duration of three years; and
- requirements for the conduct and reporting of actuarial investigations.

APRA received a significant number of submissions on the draft prudential standards, including on draft SPS 160. These included that a transition to the shorter actuarial reporting timeframe was necessary, that the concept and purpose of the shortfall limit needed clarification and that it was not necessary to maintain reserves against self-insurance liabilities in a defined benefit fund.

APRA took note of the issues raised in submissions on the draft standard and the final version of SPS 160, determined and released on 28 June 2013, incorporates a number of changes including:

- phasing in over three years of the requirement to report within six months on the triennial actuarial investigation;
- clarification of several matters including the purpose of the shortfall limit, and the application of the standard to defined benefit sub-funds and certain public sector schemes;
- recognition that arrangements other than reserves for the management of self-insurance liabilities may be approved by APRA; and
- introduction of the term ‘RSE actuary’ and application of certain requirements in SPS 160 directly to RSE actuaries appointed by RSE licensees.

#### **4. Regulation Impact Statement**

A Regulation Impact Statement has been prepared and has been lodged as supporting material.

**5. Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011***

A Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* is provided at Attachment A to this Explanatory Statement.

**ATTACHMENT A**

**Statement of Compatibility with Human Rights**

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

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This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instrument listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (HRPS Act)

**Overview of the Legislative Instrument**

The purpose of making this legislative instrument is to make SPS 160, which sets out prudential requirements for the management of defined benefit funds with the objective of enabling the RSE licensee of the fund to meet the liabilities of the fund, out of the assets of the fund, as the liabilities become due.

The key requirements of SPS 160 are that an RSE licensee of a defined benefit fund must:

- appoint an RSE actuary to undertake, and report on, regular actuarial investigations into the financial position of a defined benefit fund;
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Other specific requirements relate to:

- application of the prudential standard to defined benefit sub-funds; and

- if the fund is permitted to self-insure benefits, arrangements for regular actuarial oversight, annual attestation that the self-insurance continues to be in the best interests of beneficiaries, and development of a contingency plan for an orderly wind-up of the self-insurance.

This is a new prudential standard which applies to RSE licensees in order to implement the Government's Stronger Super reforms that come within APRA's mandate.

### **Human rights implications**

APRA has assessed the instrument against the international instruments listed in section 3 of the HRPS Act and determined that it does not engage any of the applicable rights or freedoms.

### **Conclusion**

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.