3/17/22

General Manager
Policy Development
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Dear Sir/Madam

Strengthening Financial Resilience in Superannuation

Thank you for the opportunity to participate in the consultation, *Strengthening Financial Resilience in Superannuation,* and further to our discussion session with members of ARPA's policy team on 23 February 2022.

AustralianSuper is Australia's largest superannuation fund and is run only to benefit members. Almost 2.5 million Australians are members of AustralianSuper and we invest over $250bn of their retirement savings on their behalf. Our purpose is to help members achieve their best financial position in retirement.

AustralianSuper's Position

We welcome APRA's consideration of RSE licensee financial resilience planning and consider it appropriate given the industry's growth, quantum of assets-under-management and (more recent) fund consolidation. The financial resilience of the industry is critical for members confidence in the superannuation system (and the broader financial system). The financial resilience of their fund and the funds' trustee is something that members should not need to be concerned with as the industry further consolidates.

The current capital framework for superannuation under *SPS114 Operational Risk Financial Requirement* is not as mature in comparison to banking and insurance, simply requiring a target of 0.25% of funds-under-management to be held to address operational risk events which may affect business operations. This framework ignores the specific risk characteristics of each fund and inherently assumes no difference across the industry. Banking and insurance regulatory capital frameworks incorporate the specific operational risks of each organisation in determining the individual capital adequacy requirements (along with other inputs).

AustralianSuper's internally modelled operational risk calculation concluded that a lower level of reserves could be held to reflect both the organisation's inherent risk characteristics, and significant investment to uplift our risk management framework. If the reserves are excess to modelled requirements and those members' funds cannot be invested in line with the broader fund's investment strategy, it cannot be concluded that the current capital framework is in members' best financial interests.

We recommend that APRA consider a broader capital adequacy standard covering all reserves, including those established for operational risk events. In doing so, the amounts required to be put aside by funds should reflect each individual fund's characteristics, including size and operational risk profile.

In considering any changes to the capital requirements for APRA regulated superannuation funds, APRA will need to be cognisant of the potential impact to <u>all</u> participants and specifically member impact.

Any changes that could require additional capital will ultimately come from our members in either fees or impacts to investment returns. Consideration of impacts to the performance test and APRA heatmap disclosure is paramount along with ensuring the best outcome in retirement for members. This includes ensuring that any changes to the regime are in the best financial interest of members.

This submission provides answers to the questions in the discussion paper (Questions 1 to 26).

Chapter 2: Financial resources – purposes and sources

1. What sources of funding and support are used by RSE licensees to address each of the three purposes of financial resources set out in 2.1? Is this likely to change in the near term, and if so, how?

The sources of funding and support used by AustralianSuper to address each of the three purposes of financial resources set out in 2.1 are:

- Fee revenue from fees charged to members for investment of their funds and administration of their account; and
- Insurance provided by an external insurer

We are not expecting any changes to funding in the near term.

2. When establishing or reviewing a trustee fee to be charged to members, how do RSE licensees determine the appropriateness and level of the fee? How do the sources of funding influence fee design?

Our approach 'fee design'

Pricing changes are governed by the AustralianSuper's Pricing Principles Policy. Our approach to pricing is an essential component to helping members achieve their best financial position in retirement. As a profit-for-member Fund, the fees charged to members across a range of products and services should reflect the costs required to operate the Fund efficiently, execute the strategy and meet all our obligations and service and support members through to, and during their retirement. When considering pricing for products and services, we view them through five principles:

- Competitive
- Equitable
- Sustainable
- Simple
- Compliant

Each of the Fund's products need to generate sufficient surplus to allow for ongoing investment in the Fund to remain competitive. We endeavor to allocate all costs fairly across members and products. Where those costs are directly related and can be identified as such, they should be passed on in pricing. In addition to direct costs the Fund allocates indirect costs fairly across all products. The guiding principle should be equity amongst members. Pricing of products also needs to consider the Fund's obligations in relation to Regulatory Guide 97 'Disclosing fees and costs in PDSs and periodic statements'. RG97 stipulates the use of reserves will need to be considered in the published price in product disclosure documentation.

Our pricing is reviewed by the Product Pricing Committee and approved by the Member Employment Services Committee, and Finance and Administration Committee, and ultimately the Board.

Trustee fees Specific to the Trustee Risk Reserve

No additional fee has been charged to AustralianSuper members when establishing the Trustee Risk Reserve.

a. *Appropriateness and level of the fee*

The Target Amount of the Trustee Risk Reserve is determined by the Board based on recommendations of management endorsed by the Finance and Audit Committee. The Target Amount was set with effect from 1 January 2022 and will be reviewed as at 1 January 2023 and thereafter it will be reviewed at least biennially in line with the Trustee Risk Reserve Policy and in accordance with Rule 4A of the Fund's Trust Deed. We note that Rule 4A of the Fund's Trust Deed is a recent amendment by the Supreme Court of South Australia.

The Target Amount may vary depending on the particular circumstances affecting the operation of the Fund at a point in time, including any recent or upcoming legislative or regulatory changes, known risks, known risk mitigants and recent or upcoming changes in the size, business mix and complexity of the Fund.

The recommendations of management in relation to the Target Amount will be informed by an annual scenario testing exercise in 2023 and thereafter a biennial scenario testing exercise designed to risk assess the potential for penalties, the possible materiality of those penalties and the amount of reserved funds required to cover them. The methodology for this exercise will be determined by the Group Risk department in consultation with Fund actuaries and, if considered desirable by management or the Board, appropriately experienced external consultants. It is expected that the methodology and recommendations will have regard to:

- a ‘data set’ of legislative and regulatory obligations that may result in a penalty;
- the probability and value of penalties being incurred;
- the potential availability and cost of insurance cover; and
- any APRA prudential standards or guidance as to capital adequacy.

b. How do the sources of funding influence fee design?

The fee design of the Trustee Risk Reserve Fee is set out in Rule 4A of our Trust Deed. Rule 4A places a cap on the annual Trustee Risk Reserve Fee. For each financial year, the Trustee Risk Reserve Fee can be no more than 0.015% of AustralianSuper’s net assets calculated as at the end of the previous financial year. Rule 4A also prevents the Trustee from charging a Trustee Risk Reserve Fee if the balance in the Trustee Risk is more than 0.015% of AustralianSuper’s net assets calculated as at the end of the previous financial year (or another maximum amount set by relevant superannuation law or the relevant superannuation regulator).

3. Are there additional relevant considerations to those detailed in the table that affect how and when RSE licensees can access external financial resources? If so, please provide details.

We take into account any legislative or regulatory impediments in accessing financial resources, such as the prohibition on charging of the Fund’s assets, such as Reg 13.14 of the *Superannuation Industry (Supervision) Regulations 1994* (Cth) which prohibits a Trustee from charging the assets of its fund.

Chapter 3: Managing financial resources

4. How do RSE licensees determine the adequacy of their financial resources to address each of the three purposes of financial resources set out in 2.1? Are further enhancements to these processes anticipated?

The adequacy of financial resources addressing the three purposes are determined on a Business As Usual (BAU), Business Plan and contingency basis.

a. *Continue to operate the business – (BAU budget)*

The plan of the revenue and costs to operate the business is prepared as part of the annual budgeting process. This is done on a rolling three-year basis and is built up through detailed individual department plans by spending category. An integral element of the process is to evaluate the impact on the relevant reserves to ensure the adequacy of balance sheet capacity for the planned expenditure.

b. *Deliver on the Business Plan – (Change Budget)*

From an ongoing monitoring perspective, detailed financial results are presented to the relevant governance forums monthly – at both a whole-of-fund and individual departmental level. In addition, the Fund runs at least two forecasts during the financial year to provide a forward-looking view to stakeholders of the expected outcome versus the budget. From this information, stakeholders can make decisions as appropriate to correct the trajectory of the Fund’s expenditure.

c. *Fund contingency expenditure items – (Reserves)*

As part of the annual budget process, the Fund models the target for the Administration Reserve, which is set at a level to ensure:

- There is adequate funding to provide liquidity to shield the business in volatile times;
- Provide funds to capitalise on opportunities that will support the strategy of the Fund (including mergers); and
- Provide the ability to undertake and maintain investment plans across years.

For the Insurance Reserve, the Fund sets the Target level to meet the Annual Premium Adjustment due to the insurer under a 1-in-40 year adverse claims event for death and a 1-in-100 year adverse claims event for Total and Permanent Disablement (TPD) and income protection. The purpose of this is to also provide relative stability in annual changes to the member insurance premiums.

5. How do RSE licensees monitor the adequacy of financial resources? Which factors would trigger a review of resources?

The RSE licensee has extensive processes and controls which are used to monitor the adequacy of the financial resources, which comprise:

- Three-year financial plan for the Trustee and Fund, approved by the Board, which is refreshed on an annual cycle. The plan is based on actuarially modelled expectations for member numbers and FUM growth – which are then used to set guardrails for expenditure that ensure target levels of reserves are maintained over the duration of the planning period;
- Monthly financial performance report presented to Executive, Board Committees and Board, which covers the following:
    - Membership and Financial Scorecard
    - Membership and Pension numbers
    - Fund flows
    - Funds Under Management
    - Fund expenditure, including projects and investment costs
    - Net surplus
    - Administration, ORFR and other reserves
    - Employee and contractor headcount
    - RG97 measurement;
- Bi-annual detailed re-forecast of the annual plan to re-calibrate for actual performance – and expected future performance over the remainder of the fiscal year; and
- Monthly Crediting Rate Governance Committee at which the funding rate of the ORFR is discussed and set to ensure maintenance of the target level.

6. To what extent does scenario testing inform the financial projections in the business plan? How does scenario testing inform the determination and assessment of the adequacy of financial resources?

The business planning process involves iterating successive budget scenarios. This involves the preparation of an integrated build of revenue and expenses and the impact of the reserves across a three-year budget horizon. The budget scenario will go through multiple iterations to arrive at the final view of financial adequacy for submission to the Board for approval.

7. Have there been instances where an RSE licensee experienced an operational risk event that would have permitted them to call on the ORFR financial resources?

Yes. Refer to responses below for detail.

a) If so, did the RSE licensee use the ORFR financial resources to make good any loss experienced by members?

Since July 2013, the RSE licensee has used the ORFR on nine occasions to make good losses experienced by members. The total amount of the reserve used for those make good payments was $43 million.

b) If the RSE licensee decided to not call upon the ORFR financial resources, what were the factors that influenced the decision?

Historically, the RSE licensee's policy was to only use the ORFR to make good operational risk event losses greater than $1 million. There have been occasions where the reserve was not used due to this policy constraint. The RSE licensee's policy was amended on 25 February 2021 to remove the $1 million threshold.

8. Are RSE licensees likely to change their approach to the use and maintenance of the ORFR?

As detailed in response to question 7 b), the RSE licensee's policy was amended on 25 February 2021 to remove a $1 million limit on using the ORFR to make good operational risk event losses. The RSE licensee does not envisage any future changes to its approach to the use and maintenance of the ORFR whilst the current versions of SPS 114 and SPG 114 remain in force.

9. Are there any other views you wish to provide about the role of the ORFR in supporting RSE licensee financial soundness, including any potential improvements?

The RSE licensee considers that a mandated minimum ORFR target for all superannuation funds, regardless of size or risk profile, is no longer appropriate given the increased maturity of the industry since the minimum mandate was introduced.

In the RSE licensee's view, the ORFR target should reflect scale benefits for the following reasons:

- There is a minimum level of capital that a fund should hold in order to protect members against an operational risk event. It does not hold true that this level should rise proportionately in line with members' assets;
- Internal modelling conducted by the RSE licensee since the beginning of the ORFR requirements has shown that the potential loss that the AustralianSuper fund is exposed to has not risen at the same rate that members' assets have grown;
- The superannuation industry is projected to grow to $6.3 trillion by 2030. If the minimum ORFR target remains in place, the industry would need to set aside $16 billion in ORFR reserves;
- A flat bps target does not reflect the ongoing investment which AustralianSuper is making in its Risk Management Framework which aims to reduce the likelihood of an operational risk incident;
- AustralianSuper had an ORFR balance of $652 million at 31 December 2021 and has only drawn down $43 million since 2013. AustralianSuper's ORFR balance is projected to exceed $1 billion by the end of FY25 and $2 billion by 2030. An excessive ORFR balance is not in members' best financial interests, as it reduces the income earned in members' accounts, thereby reducing their final retirement balances; and
- The Australian banking and insurance industries have examples of entity-specific capital requirements based on size and risk. As the superannuation industry matures, the RSE licensee believes this practice should be extended to superannuation funds.

<u>Recommendation</u>

> *Rather than mandating a minimum amount to be set aside to cover operational risk event losses, the RSE licensee recommends APRA develop a broader capital adequacy standard covering all reserves for superannuation funds, including those established for operational risk events. In doing so, the amounts required to be put aside by funds should reflect each individual fund's characteristics, including size and risk profile.*

10. To what extent are reserving policies driven or limited by requirements in trust deeds? Please provide reserving policies, where possible.

Our reserving policies are provided with this submission on a strictly confidential basis, and therefore, we request that they are treated as Commercial-in-Confidence documents. Our reserving policies are consistent with the requirements of our Trust Deed.

11. How often are reserving policies reviewed? Is there a defined framework and what factors are considered in the review process?

- Administration Reserve Policy - the policy itself is reviewed every two years
- Insurance Reserve Policy - the policy itself reviewed every two years
- Investment Reserve Policy - the policy itself is reviewed every two years
- Operational Risk Financial Requirement Policy - the policy itself is reviewed annually
- Reserve Policy Framework - the policy itself is reviewed every two years
- Trustee Risk Reserve Policy - the policy itself is reviewed at least every three years

As specified in the Appendix A Table, there is a framework for reviewing the reserving policies and this includes the adequacy of the reserve levels/target amount.

12. For all reserves held by RSE licensees:

a. For what specific purpose are the reserves held and used?

Please see Appendix A Table.

b. How are these reserves initially funded, maintained and replenished?

Please see Appendix A Table.

c. How is the target amount for these reserves held? How are financial projections and stress testing utilised in determining target amounts?

Please see Appendix A Table.

d. How are reserves invested, and how does the RSE licensee ensure that the investment strategy for each reserve aligns with the purpose of the reserve? How do liquidity management considerations inform these decisions?

Please see Appendix A Table.

e. What controls are in place to ensure reserving approaches are equitable for members in both how the reserve is built (e.g. fee), managed and used?

Please see Appendix A Table.

13. Are RSE licensees likely to change their approach to the type and purpose of reserves held? If so, why?

Please see our answers to Question 9. We believe an integrated capital adequacy approach that adopts a risk-based approach is preferable.

14. How have the RSE licensee's reserving practices and policies been amended to ensure compliance with the best financial interests duty?

Our reason for wanting an integrated capital adequacy approach is that, in our view, it is not in the best financial interests of members to have excessive reserves, for example, an ORFR of more than $1 billion. Subject to our comments on the current regulatory requirements of the ORFR, it's our belief that our current practices and policies comply with the best financial interests duty.

15. Please provide a summary of the insurance coverage held by the RSE licensee and/or the RSE licensee directors.

This is commercial-in-confidence information which if obtained and exploited by third parties may be extremely detrimental to our members. We are happy to verbally discuss the details or, what may be more useful, is for APRA to obtain industry data from insurance brokers.

a) **How is this insurance held (by the RSE licensee directly or by a related entity)? Where it is held by a related entity, please describe any contingencies in place in the event the insurance becomes unavailable.**

It is held by the RSE licensee**.**

b) **For any director's liability insurance (such as Directors and Officers Insurance and Professional Indemnity), please provide information about the terms of the contract, such as: limits, deductibles, exclusions and the basis of cover (Losses occurring or Claims Made form).**

This is commercial-in-confidence information which if obtained and exploited by third parties may be extremely detrimental to our members. We are happy to verbally discuss the details or, what may be more useful, is for APRA to obtain industry data from brokers.

16. What factors are considered when making decisions regarding the types and levels of insurance acquired? How are these factors prioritised when deciding on insurance arrangements?

Factors considered are:

- Areas of potential exposure which includes assessing different scenarios and modelling. Prima facie this dictates the types and quantum of insurance being sought.
- With the assistance of our broker, we then assess our ability to secure the insurances given the status of the insurance market which is currently "hard". A hard insurance market means that insurers either do not offer the insurance or do so for increased premiums and/or increased deductible and/or policy exclusions.
- Again, through the assistance of our broker, we determine what insurers we go with based on their credit rating and claims management history.

The priorities are:

- The first priority is to be able to secure some form of insurance. Without it, members bear the cost of any losses
- The second priority is to assess the policy terms ie: whether the level of premiums charged is acceptable and considered value for money and/or whether the deductible is acceptable and/or agree to a level of sum insured based on the perceived likelihood of certain events occurring, our size, the existence of a considerable ORFR and other reserves. We do rely on our broker's experience to assist in evaluating the reasonableness of the insurance offer.
- In terms of policy exclusions, the decision is based on the likelihood of the excluded event occurring and the reasonableness for the exclusion.

17. What are the challenges, if any, in obtaining and renewing insurance coverage and how are RSE licensees managing these challenges?

- We are challenged by the perception by insurers of the risks associated with insuring the Australian financial services industry. In particular, the impact of losses incurred by insurers in relation to events involving other parties eg: class actions against other financial institutions, the Royal Commission, increasing ransomware attacks etc. Those events have resulted in significant premium and deductible increases, an expansion of policy exclusions or some insurers withdrawing from the market altogether.
- Via our brokers, we negotiate what we regard as acceptable terms with our insurers. However, as global insurance markets have hardened, we are considering alternate options other than retail insurance.

- We are currently evaluating other possible alternatives, including establishing captive insurance. This work is in its infancy.

18. How does the RSE licensee and/or the RSE licensee directors determine the types and levels of insurance coverage needed to address risks that could impact their resilience?

We perform our own scenario modelling for the purposes of evaluating our ORFR. From time to time we ask our broker or a third party to independently assess whether we have sufficient insurance. Our broker also provides us with benchmarking.

19. How does the RSE licensee and/or the RSE licensee directors assess the continuing adequacy of insurance coverage, and how often is this assessment undertaken?

The scenario modelling for the ORFR is performed every year. The independent verification occurs every 2-3 years and the benchmarking is performed almost annually. This information is presented to the Risk and Compliance Committee so that it can assess whether the levels of insurance are adequate.

20. What contingencies are in place for a scenario in which an insurance claim is unsuccessful, or if insurance becomes unavailable or is perceived as not representing value for money?

If we were to have an insurance claim which proved to be unsuccessful, we would have to utilise the ORFR or some other reserve to make good the loss. To the extent that one of our third party service providers was responsible for the event resulting in the loss, and our contract with that third party provided us with a right to be indemnified for that loss, we would make a claim for such indemnification.

We are currently evaluating some options in the event that insurance becomes unavailable or not perceived to represent value for money (refer Question 17).

21. Please provide any other information that may be relevant to inform APRA's understanding of the insurance coverage held by the RSE licensee and/or the RSE licensee directors.

This is commercial-in-confidence information which if obtained and exploited by third parties may be extremely detrimental to our members. We are happy to discuss the details with APRA or APRA may wish to obtain industry data directly from insurance brokers.

22. How do RSE licensees' provision for contingency expenditure items? To what degree does this form part of the RSE licensees' business planning process?

Refer to Questions 4, 5 and 6 – and specifically 4(c).

23.How do RSE licensees fund restructures of their business operations?

Any restructuring decision would be made in the best financial interests of our members and would be funded from the Administration Reserve. Major restructures would be incorporated into the financial plan.

24.How are RSE licensees sourcing funds for the payment of civil or administrative penalties from 1 January 2022? To what degree have alternate avenues been considered when settling on the source of funding?

AustralianSuper has established a Trustee Risk Reserve Fee – see discussion in the Appendix A Table about the Reserve – which was created through amendments to the Trust Deed by the Supreme Court of South Australia. As an alternate avenue, we will obviously still continue to utilise insurance to the extent that: (1) the policy will respond in the particular situation; and (2) the penalty is less than the deductible/excess.

AustralianSuper considered the following alternate avenues:

(1) *Insurance* – which we will continue to utilise and we consider insurance as only a partial solution rather than a complete solution;

(2) *Capital contributions from shareholders* – given the nature of profit-to-member funds whereby shareholders are not entitled to receive dividends and profits, it is not appropriate for shareholders to contribute capital, and therefore this was not an option for AustralianSuper. *This is a significant point-of-difference between Industry and Retail funds, which APRA should take into consideration in its evaluation of financial resilience across the superannuation industry to ensure members of Industry funds are not penalised by virtue of the capital structure of such funds.*

25. If intending to build financial resources of the RSE licensee by deducting amounts from existing reserves, how would affected reserves be replenished and how might this approach affect fees charged to members?

One of the objectives of the planning process is to budget fees and costs to ensure there is sufficient balances in reserves. If reserves required replenishing, this could be achieved by managing expenses, increasing fees or some combination of both. These decisions would need to made in line with obligations the Fund has to its members.

26. How are RSE licensees estimating the quantum of funds to be held at the trustee company level for the purpose of paying penalties?

The Target Amount of the Trustee Risk Reserve is determined by the Board based on recommendations of management endorsed by the Finance and Audit Committee. The Target Amount was set with effect from 1 January 2022 and will be reviewed as at 1 January 2023 and thereafter it will be reviewed at least biennially.

The Target Amount may vary depending on the particular circumstances affecting the operation of the Fund at a point in time, including any recent or upcoming legislative or regulatory changes, known risks, known risk mitigants and recent or upcoming changes in the size, business mix and complexity of the Fund.

The recommendations of management in relation to the Target Amount will be informed by an annual scenario testing exercise in 2023 and thereafter a biennial scenario testing exercise designed to risk assess the potential for penalties, the possible materiality of those penalties and the amount of reserved funds required to cover them. The methodology for this exercise will be determined by the Group Risk department in consultation with Fund actuaries and, if considered desirable by management or the Board, appropriately experienced external consultants. It is expected that the methodology and recommendations will have regard to:

- a ‘data set’ of legislative and regulatory obligations that may result in a penalty;
- the probability and value of penalties being incurred;
- the potential availability and cost of insurance cover; and
- any APRA prudential standards or guidance as to capital adequacy.

Rule 4A of the Trust Deed of the Fund provides (among other things) that:

- for each financial year of the Fund commencing with the financial year ending 30 June 2022, a Trustee Risk Reserve Fee is payable to the Trustee in an amount equal to 0.015% per annum of the net assets of the Fund calculated as at the end of the previous financial year (the **Annual Fee Cap**); and
- the Trustee Risk Reserve Fee is to be paid in such periodic instalments as are determined by the Trustee from time to time;
- the Trustee:
    - must suspend payment of further amounts of the Trustee Risk Reserve Fee if and to the extent and for so long as (but only for so long as), immediately following such payment, the balance of the Risk Reserve would exceed an amount (the **Risk Reserve Cap Amount**) equal to the greater of:

    - an amount equal to the Trustee Risk Reserve Fee payable for that financial year; and
    - such amount (if any) as the *Superannuation Industry (Supervision) Act 1993* or regulations made thereunder or licensing provisions of *the Corporations Act 2001* or regulations made thereunder require or as a Responsible Authority directs the Trustee to hold as capital on its own account; and
  - may otherwise determine in its absolute discretion to reduce, waive, suspend or postpone the Trustee Risk Reserve Fee (or any part of it) and, subject to sub-paragraph (i), to cease such reduction, waiver, suspension or postponement.

Management will recommend to the Board via the Finance and Audit Committee, on an annual basis, the amount of the Trustee Risk Reserve Fee to be paid into the Risk Reserve that year and the terms upon which it will be paid. Such amount cannot exceed the Annual Fee Cap, but a reduced amount or fee suspension may be recommended. In recommending the amount of the Trustee Risk Reserve Fee, management must demonstrate that due consideration has been given to:

- the Annual Fee Cap and the Risk Reserve Cap Amount;
- the balance of the Risk Reserve;
- the most recent Target Amount analysis that has been undertaken;
- any recent experience of the Trustee in using the Risk Reserve and the experience of the industry in relation to Breaches and the payment of Penalties;
- how the Trustee Risk Reserve Fee will be funded from the assets of the Fund, including from other reserves;
- the timing of the payment or payments of the Trustee Risk Reserve Fee; and
- the opportunity cost of removing money from the Fund and any likely impact on the fees and costs payable by members of the Fund.

Once the annual Trustee Risk Reserve Fee has been approved by the Board, management is responsible for implementing payment of the Trustee Risk Reserve Fee from the Fund to a separate account to be held by the Trustee in its personal capacity. Such account represents the Risk Reserve.

What options would be available for reducing a surplus at trustee company level in the event that the provisioning requires adjustment?

Our Trustee Risk Reserve Policy provides the Board with discretion to repatriate amounts from the Trustee Risk Reserve into the Fund from time to time.

If you have any questions regarding our submission, please do not hesitate to contact **Matt Harrington, Head of Finance & Operations**, at mharrington@australiansuper.com.

Yours sincerely

Peter Curtis
Group Executive – Finance & Operations

Appendix A Table for Question 12 (a to e)

Reserve	(a) Purpose	(b) Funding	(c) Target amount	(d) Investing	(e) Controls
Administration	Receive and hold the necessary funding to meet operating and capital costs and expenses of administering and managing the Fund and its controlled and related entities. The Reserve may be used to fund both Domestic (Australia) and International operating and capital costs and expenses.	The main source of funding is Administration Fees deducted from Member Accounts, supplemented by investment earnings on the reserve balance.	The target level is driven by the working capital requirements and the expected capital costs associated with administering the Fund.	Due to the working capital nature of the Reserve it is invested in low risk liquid assets such as cash and short-term deposits.	The charging of Administration fees is governed by the Trustee's Pricing Policy. Through the application of this policy, the Fund seeks to minimise the degree of cross subsidisation between different classes of members, products and services offered. The Trustee has various controls in place to ensure the expenditure funded by the reserve complies with the members' best financial interest requirements, including a rigorous budgeting process and financial delegation policy. The Trustee reconciles the reserve monthly.
ORFR	APRA provides the requirements and supporting principles of the operational risk financial reserve. The Reserve may only be used to fund an Operational risk event.	Ongoing funding is primarily sourced from the Investments reserve and earnings from the funds invested in the reserve.	The Target level consists of three amounts. The first amount is determined by performing annual scenario testing to determine the losses AustralianSuper may potentially be exposed to. Modelling is applied to determine the probabilities of identified losses	In alignment with liquidity requirements, AustralianSuper can invest up to 50% in the Balanced Option and the remainder in cash or cash equivalents. This class of investment may only be changed on the approval of the	Board approval is required if circumstances dictate funding of the reserve should reflect anything other than proportional contributions from MySuper beneficiaries and Choice beneficiaries based on relative FUM.

			occurring in any given year. The amount factored into the Target level will reflect at least the 95th percentile of the outcomes of the modelling. The second component of the Target level is an additional amount to allow for operational risks that have not been specifically identified from the scenario analysis modelling. The third component is the amount required to ensure that the Target level is at least equal to the minimum level set by APRA, currently 25 basis points of FUM.	Board.	A strict approval process is in place to ensure appropriate use of the reserve. The Trustee reconciles the reserve monthly.
Investment	The reserve accumulates Net Investment Income or Net Investment Losses prior to it being allocated to members' accounts.	The Investment Reserve is primarily funded from investment earnings on the investments underpinning the member Investment options, including realised and unrealised gains/loss, interest, dividends and distributions.	The target amount for the Investment Reserve is zero. Due to estimates used within the calculation of the crediting rate and the timing of cash flows on the member and investment systems, the Investment Reserve may have a surplus or deficit at any particular time.		The Trustee reconciles the reserve monthly.
Insurance Reserve	The reserve holds the funds required to: • make potential Annual Premium Adjustments due to the insurer under the Premium Adjustment Model	The Insurance Reserve is funded by: • an allocation of the members' insurance deductions each month (where applicable)	The Target level of the Insurance Reserve is determined based on the following considerations: • The potential future APAs due to the insurer in respect of	The Insurance Reserve will be invested as follows: Investment | Target amount invested	Controls are governed by Insurance Reserve Policy which is reviewed and approved every two years by the Finance Administration Committee (FAC).

	(PAM) • receive Annual Premium Adjustments due to AustralianSuper from the insurer under the PAM and investment earnings • use those amounts to meet insurance premium costs and to stabilise premiums for members over time	• investment earnings and tax deductions • APAs received from (or paid to) the insurer	every past and current claims • The claims that would arise using a high degree of probability of a claims event; and • Provide relative stability in annual changes to the member insurance premiums.	Balanced Option: 50% of *Target* Insurance Reserve Cash: Balance of Insurance Reserve	Controls include: • Setting a quantum Target level of the Insurance Reserve which is reviewed annually by the FAC. • The Insurance Reserve is separately accounted for in the general ledger. • The Group Executive Finance and Operations approves and signs off on the Insurance Reserve annually.
Trustee Risk Reserve	The Risk Reserve has been established to address the risk requirements of the Trustee, including as a control measure against trustee insolvency where costs are incurred in connection with the Trustee's role as trustee of the Fund. In particular, the Risk Reserve provides financial resources outside the Fund to ensure the ongoing solvency of the Trustee such that it may pay any amount which the Trustee considers necessary or desirable to pay in discharging liabilities or managing any	The Trustee Risk Reserve Fee is paid into the Trustee Risk Reserve. The Trustee Risk Reserve Fee is currently funded from the Administration Reserve. In the event that a material payment (exceeding 10% of the balance of the Risk Reserve) is made from the Trustee Risk Reserve, management will review the balance of the Trustee Risk Reserve as against the Target Amount and develop a replenishment plan taking into account the Annual Fee Cap and Risk Reserve Cap	The Target Amount of the Trustee Risk Reserve is determined by the Board based on recommendations of management endorsed by the Finance and Audit Committee. The Target Amount was set with effect from 1 January 2022 and will be reviewed as at 1 January 2023 and thereafter it will be reviewed at least biennially. The Target Amount may vary depending on the particular circumstances affecting the operation of the Fund at a point in time,	The Trustee Risk Reserve must be invested by the Trustee in a manner that is appropriate having regard to the purpose of the Trustee Risk Reserve and the following principles: • seeking an appropriate risk-adjusted return; • preserving capital and income (that is, limited volatility of return and limited risk of capital loss); and	The Trustee Risk Reserve Policy governs the establishment, purpose, funding, management and application of the Trustee Risk Reserve, being the balance of funds held from time to time by AustralianSuper Pty Ltd (the **Trustee**) as capital on its own account which is referable to the payment of a fee (to the Trustee from the Fund in accordance with Rule 4A of the Trust Deed of the

	personal financial risk of: • the Trustee in connection with its role as trustee of the Fund; and • any director or officer of the Trustee in connection with their role as director or officer of the Trustee, to the extent the Trustee can indemnify the director under the Corporations Act.	Amount. Where the replenishment plan requires a change to the approved Trustee Risk Reserve Fee for that year, this change will be provided to the FAC for review and endorsement prior to being presented to the Board for approval.	including any recent or upcoming legislative or regulatory changes, known risks, known risk mitigants and recent or upcoming changes in the size, business mix and complexity of the Fund. The recommendations of management in relation to the Target Amount will be informed by an annual scenario testing exercise in 2023 and thereafter a biennial scenario testing exercise designed to risk assess the potential for penalties, the possible materiality of those penalties and the amount of reserved funds required to cover them. The methodology for this exercise will be determined by the Group Risk department in consultation with Fund actuaries and, if considered desirable by management or the Board, appropriately experienced external consultants. It is expected that the methodology and recommendations will have regard to: • a 'data set' of legislative and regulatory obligations that may result in a penalty;	• maintaining appropriate liquidity to meet the payment of amounts from the Trustee Risk Reserve. Net investment earnings or losses (after tax and costs) derived from the investment of the Trustee Risk Reserve will be credited or debited to the Trustee Risk Reserve.	Fund) (the **Trustee Risk Reserve Fee**). As the Trustee Risk Reserve Fee is funded out of the Administration Reserve, the reserving approach is equitable amongst members of the Funds.

			• the probability and value of penalties being incurred; • the potential availability and cost of insurance cover; and • any APRA prudential standards or guidance as to capital adequacy. Rule 4A of the Trust Deed of the Fund provides (among other things) that: • for each financial year of the Fund commencing with the financial year ending 30 June 2022, a Trustee Risk Reserve Fee is payable to the Trustee in an amount equal to 0.015% per annum of the net assets of the Fund calculated as at the end of the previous financial year (the Annual Fee Cap); and • the Trustee Risk Reserve Fee is to be paid in such periodic instalments as are determined by the Trustee from time to time; • the Trustee: o must suspend payment of		

			further amounts of the Trustee Risk Reserve Fee if and to the extent and for so long as (but only for so long as), immediately following such payment, the balance of the Risk Reserve would exceed an amount (the Risk Reserve Cap Amount) equal to the greater of: ▪ an amount equal to the Trustee Risk Reserve Fee payable for that financial year; and ▪ such amount (if any) as the Superannuation Industry (Supervision) Act 1993 or		

			regulations made thereunder or licensing provisions of the Corporations Act 2001 or regulations made thereunder require or as a Responsible Authority directs the Trustee to hold as capital on its own account; and o may otherwise determine in its absolute discretion to reduce, waive, suspend or postpone the Trustee Risk Reserve Fee (or any part of it) and, subject to sub-paragraph (i), to cease such		

			reduction, waiver, suspension or postponement. Management will recommend to the Board via the FAC, on an annual basis, the amount of the Trustee Risk Reserve Fee to be paid into the Risk Reserve that year and the terms upon which it will be paid. Such amount cannot exceed the Annual Fee Cap, but a reduced amount or fee suspension may be recommended. In recommending the amount of the Trustee Risk Reserve Fee, management must demonstrate that due consideration has been given to: • the Annual Fee Cap and the Risk Reserve Cap Amount; • the balance of the Risk Reserve; • the most recent Target Amount analysis that has been undertaken; • any recent experience of the Trustee in using the Risk Reserve and the experience of the industry in relation to Breaches and the		

			payment of Penalties; - how the Trustee Risk Reserve Fee will be funded from the assets of the Fund, including from other reserves; - the timing of the payment or payments of the Trustee Risk Reserve Fee; and - the opportunity cost of removing money from the Fund and any likely impact on the fees and costs payable by members of the Fund. Once the annual Trustee Risk Reserve Fee has been approved by the Board, management are responsible for implementing payment of the Trustee Risk Reserve Fee from the Fund to a separate account to be held by the Trustee in its personal capacity. Such account represents the Risk Reserve.		