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Operational risk reserves for super...



How would your fund recover from a major operational incident?

What would you like to change?

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Operational risk reserving

As Trustees grapple with increasingly large and complex operations, equity between members and new regulator guidance on risk management and use of reserves ¹, the need for a systematic approach to dealing with operational risk has never been greater.

Historically many funds' reserves have reflected what is left over after fees are collected and expenses are paid. Whether these reserves would be sufficient to meet the cost of a significant risk event such as a crediting rate /unit pricing error or a fraud is uncertain.

Assumptions have been made on the ability to recover costs from third parties without consideration of the potential for prolonged delay in pay out and the impact of this on current members.

Superannuation funds are now beginning to consider operational risk in a more systematic manner, using a scenario lead approach, similar to that adopted in the banking sector in assessing elements of their capital requirements. This provides a more robust basis for setting reserves and reflects that, while third parties may ultimately contribute to reduce the fund's loss, this may not occur promptly enough to avoid an inequitable impact on current members.

Risk appetite, process and governance

The process for establishment and operation of the reserve involves:

1. Working with fund executives, our approach brings together experts in superannuation operations and controls and risk management. This approach assists in ensuring completeness of risks and depth of analysis. It also allows for identification of areas where control gaps exist and where insurance may be inadequate
2. Using modeling techniques, our risk specialists analyse average annual loss for a range of confidence levels. This provides the basis for explicit consideration of trustee risk appetite
3. Once the optimum level of reserve is determined, we work with the trustee to establish a process and policies for build up and draw down including trigger events, protocols and timeframe for reserve recovery

Footnote: SPG 200 – Risk Management (due to be finalised end Q1 2010).
SPG 235 – Use of reserves in superannuation funds.

The diagram below illustrates the need for close examination of the way organisations provision for risk. In the event of a major operational incident adequate reserves are critical, particularly where there is a prolonged insurance payout or an inability to rely on insurance.

High level view of potential scenarios after a significant risk event occurs

