



# RESERVING MANAGEMENT POLICY

DRAFT

## Table of Contents

1. OVERVIEW .....	3
2. PURPOSE.....	3
3. LEGISLATIVE REQUIREMENTS.....	3
4. DEFINITIONS .....	3
5. WHAT ARE RESERVES, AND WHY WOULD THEY BE HELD?.....	3
6. COMMON TYPES OF RESERVES .....	4
7. ADMINISTRATION RESERVE AND ASSOCIATED INVESTMENT STRATEGY .....	4
8. INVESTMENT FLUCTUATION RESERVE AND ASSOCIATED INVESTMENT STRATEGY .....	5
9. OPERATIONAL RISK RESERVE AND ASSOCIATED INVESTMENT STRATEGY .....	5
10. RESERVES THRESHOLDS.....	6
11. ANNUAL REVIEW .....	6
12. RELATED POLICIES .....	6
13. ATTACHMENT 1: PRUDENTIAL STANDARD 1/2014, PARAGRAPHS 14 AND 15.....	7
14. DOCUMENT CONTROL.....	9

DRAFT

## 1. OVERVIEW

Nambawan Super Limited (NSL) is the Corporate Trustee of the accumulation fund, referred to as “The Fund.” The Fund is now known as Nambawan Super Limited Fund, an Authorised Superannuation Fund (ASF) as approved by the Central Bank of Papua New Guinea (BPNG).

## 2. PURPOSE

The purpose of this policy is to provide a framework for the Nambawan Super Limited (NSL) Board (the Trustee Board) when determining the approach to reserves (if any), and investment of any reserves.

## 3. LEGISLATIVE REQUIREMENTS

The Trustee Board is required to adhere to various Prudential Standards and in relation to reserving management and the investment of any funds held in reserve. Superannuation Prudential Standard 1/2014 Authorised Superannuation Fund Investments (PS 1/2014) see sections 14 and 15 as these refer in detail to Reserving Policy, and investment of any reserves (if applicable).

## 4. DEFINITIONS

Reserves are monies which form part of the net assets of the fund and which have been set aside for a clearly stated purpose.

## 5. WHAT ARE RESERVES, AND WHY WOULD THEY BE HELD?

- (a) Superannuation funds generally seek to pay out all, or virtually all, earnings for a period to the members in the Fund at that time. This is generally seen as fair to all members, whether they be current, exiting or prospective members, as those members current at any time receive current earnings (which can be negative as well as positive).
- (b) Reserves are part of the earnings of a given period, which are not paid out in that period, and are kept “in reserve” for a future period.
- (c) While reserves include monies that have not been allocated to members, not all unallocated monies constitute reserves. Unallocated monies that are not reserves include accounting concepts such as suspense accounts, and accounts for accrued expenses and provisions for administration expenses, taxation or building maintenance.
- (d) Superannuation funds may want to keep a level of reserves from one period to be spent or allocated to member accounts in a future period.
- (e) The Trustee Board is mindful of the competing interests of separate groups of members, especially the possibility that some members may pay towards a reserve and leave the Fund without receiving a corresponding benefit. For reasons of member fairness therefore, the Trustee Board expects Crediting Rates to reflect Fund earnings in the relevant period (which may be positive or negative).
- (f) Where reserves are maintained, the Trustee Board will establish a comprehensive management strategy which will contain appropriate objectives for which the reserves are established as well as measures to manage the reserves

- (g) Before establishing a reserve, the Trustee Board will clearly describe why the reserve is to be established, and its ongoing purpose. If reserves are to be established, the Trustee Board may establish a separate reserve for each identified purpose.
- (h) The Trustee Board would only do so if the identified purposes are fundamentally similar in nature, and if the management of one reserve is adequate to prudently manage the separate purposes over time.

## 6. COMMON TYPES OF RESERVES

- (a) A common type of reserve is one used to smooth Crediting Rates over time, in this paper referred to as an **Investment Fluctuation Reserve (IFR)**. Some members of Superannuation Funds feel more secure if Crediting Rates were smoother, rather than having volatile returns from year to year. Other members, particularly those close to retirement, may feel disadvantaged if earnings are not distributed in full. The Australian Prudential Regulation Authority (APRA) notes that portability of benefits between funds has “caused trustees to reconsider the appropriateness of IFR’s and, as a result, many [IFR’s] have been dispensed with”. (Source: APRA Prudential Practice Guide SPG 235).
- (b) Other common reserves include funds held to pay for multi-year expenses such as system upgrades (**Administration Reserves**), or funds held in case of a future expense arising from unexpected human or system failure (**Operational Risk Reserves**).
- (c) Other types of reserves that might be maintained include Contributions Reserves, Compliance Reserves, Administration Reserves and Liquidity Reserves. The Trustee Board does not intend to open reserves to manage these risks at this time and only limit the possible reserves to manage just three specific categories: **Administration**, **Investment Fluctuation** and **Operational Risk**.

## 7. ADMINISTRATION RESERVE AND ASSOCIATED INVESTMENT STRATEGY

The Trustee Board reserves the right to create/maintain an Administration Reserve.

- (a) An Administration Reserve would be maintained to hold funds ready for future administration expenses, to ensure the Trustee’s solvency and support its business operations. Such a reserve may have merit as the Trustee for Nambawan Superannuation Fund is a not-for-profit trustee, and therefore does not have access to accrued earnings in the event of emergency. Such a reserve, therefore, may be seen as similar to minimum capital requirements for banks and insurance companies.
- (b) If the Trustee Board chooses to maintain an Administration Reserve, such a reserve is not expected to be more than 0.5% of the Net Assets of the Fund, and to never be negative. At the time of writing, the Trustee Board does not maintain an Administration Reserve.
- (c) Associated investment strategy: Funds held in an Administration Reserve will be separately accounted for, apart from the general investment pool of member’s funds. Given that such a reserve is intended to be called on to cover unexpected administration costs, the Administration Reserve funds would be invested conservatively, and in low risk investments such as bank deposits or Treasury Bills (guaranteed by the State of Papua New Guinea). The

Fund will account for such reserves separately, but the actual funds may be invested along with other Fund investments of a similar nature.

## 8. INVESTMENT FLUCTUATION RESERVE AND ASSOCIATED INVESTMENT STRATEGY

The Trustee Board reserves the right to create/maintain an Investment Fluctuation Reserve.

- (a) An Investment Fluctuation Reserve (IFR) would be maintained to hold funds for future years, in order to minimize the impact of market fluctuations on members' account balances and to smooth Crediting Rates over a number of years. For example, to increase the Crediting Rate in a year in which earnings are temporarily low, or to reduce the Crediting Rate in a year in which earnings are temporarily high.
- (b) If the Trustee Board chooses to maintain an IFR, such a reserve is not expected to be more than 2.0% of the Net Assets of the Fund, unless the Bank of Papua New Guinea (BPNG) explicitly authorises a higher reserve upon application by Nambawan. Furthermore, such reserve should never be negative. At the time of writing, the Trustee Board maintains an Investment Fluctuation Reserve.
- (c) Associated investment strategy: Funds held in an Investment Fluctuation Reserve will be separately accounted for, apart from the general investment pool of member's funds. Given that such a reserve is intended to be called on to smooth Crediting Rates in periods of temporary volatility, the IFR funds would be invested conservatively, and in low risk investments such as bank deposits or Treasury Bills (guaranteed by the State of Papua New Guinea). The Fund will account for such reserves separately, but the actual funds may be invested along with other Fund investments of a similar nature.

## 9. OPERATIONAL RISK RESERVE AND ASSOCIATED INVESTMENT STRATEGY

The Trustee Board reserves the right to create/maintain an Operational Risk Reserve

- (a) In maintaining an Operating Risk, such reserve is not expected to be more than 0.25% of the Net Assets of the Fund.
- (b) An Operational Risk Reserve would be maintained to hold funds for future years, in order to have funds available in the event of an operational error such as system or human error.
- (c) The Fund seeks to reduce operational risks to a minimum through robust policies and procedures, and policing these procedures through regular internal and external audits. The Fund has a Risk Management Framework and holds insurance policies against losses due to operational error (including fraud), and the Trustee Board does not see an Operational Risk Reserve as a substitute for proper care and diligence.
- (d) The Trustee Board expects third party providers to make good their own errors, and insurance policies are maintained as well. However, claims against a service provider or insurance policy, even if lodged immediately, will often be paid with a delay, may be settled for less than the full amount or may not be accepted by the insurance company or service provider, resulting in litigation and associated costs. An appropriate Operational Risk Reserve would assist the Trustee to meet the costs of rectifying errors without having to await the outcome of recovery action against third parties, thus benefitting members through continuity of service.

- (e) Associated investment strategy: Funds held in an Operational Risk Reserve will be separately accounted for, apart from the general investment pool of member's funds. Given that such a reserve is intended to be called on to make good the costs of operational errors, the Operational Risk Reserve funds would be invested conservatively, and in low risk investments such as bank deposits or Treasury Bills (guaranteed by the State of Papua New Guinea). The Fund will account for such reserves separately, but the actual funds may be invested along with other Fund investments of a similar nature.

## 10. RESERVES THRESHOLDS

A review of the thresholds in each of the reserves and the potential requirement for future needs will be considered at least annually.

## 11. ANNUAL REVIEW

The Trustee Board will review the Reserving Management Policy on a regular basis and at least annually.

The Chief Finance Officer is the Executive Owner of this policy and is responsible for the annual review process.

- (a) The triggers for more frequent review are:
- (i) Sudden and unexpected negative portfolio returns, leading to high prospect of negative Crediting Rate in the present period;
  - (ii) Sudden and unexpected positive portfolio returns, as these returns are unlikely to be repeatable and for reasons of member fairness some of the windfall profit might be reserved;

## 12. RELATED POLICIES

This policy is to be read in conjunction with the following policies & standards:

- (a) Crediting Rate Policy
- (b) Investment Policy Statement
- (c) Investment Strategy
- (d) Prudential Standards 1/2014 - Authorised Superannuation Fund Investments

### 13. ATTACHMENT 1: PRUDENTIAL STANDARD 1/2014, PARAGRAPHS 14 AND 15

The following is a transcript from the Prudential Standard 1/2014 Authorized Superannuation Fund investments.

#### **Paragraph 14**

##### ***Investment Objective and Investment Strategy for Reserves***

- a) The Trustee Board must:
  - (i) Consider and document the objective and purpose of each reserve which it maintains;
  - (ii) Determine an investment objective and an investment strategy for each of the reserves it maintains, which must be appropriate for the objective and purpose of maintaining each reserve.
- b) Develop and document a comprehensive Reserving Management Policy, in consultation with the Licensed Investment Manager, for all reserves which it maintains.
- c) The Reserving Management Policy must be part of the Investment Framework for the ASF and must be reviewed on a regular basis (at least annually).
- d) The Reserving Management Policy must be published in the Annual Report to members including being published on the public section of the ASF's web site.

#### **Commentary**

1. Investment fluctuation reserves are generally held for the purpose of maintaining a reserve to enable the Trustee Board to minimize the likelihood of negative crediting rates. As such, the assets held as reserves should be invested in a manner consistent with that objective and not invested in line with the general pool of assets held by the ASF for members.
2. Section 71A of the Act currently limits reserves to a maximum of not more than 2% of the total value of the assets of the ASF at that time. Where an ASF wants to operate a reserve or reserves, which in aggregate, exceed 2% of the total value of the assets of the ASF at any time, the Trustee Board must request approval in writing from the Bank for the higher percentage and for the investment objectives and strategies for the reserves.
3. If such approval is granted, the Bank may require that the Trustee Board undertake a membership education program to enhance the understanding and acceptance by the members and the general public of investment fluctuations and investment volatility.

## **Paragraph 15**

### ***Application and Management of Reserves***

- a) The Trustee Board must ensure that each reserve which it maintains must only be used in accordance with the purpose for which each reserve is established.

#### **Commentary**

1. The reserves of an ASF are monies forming part of the new assets of the ASF and have been set aside for a clearly stated purpose. Not all unallocated monies constitute reserves and this includes such things as defined benefit fund surpluses and suspense accounts used to record contributions and rollovers pending allocation to their specific members' accounts. Main classes of reserves include:
  - a) Administration reserve used to fund future administration and operational expenses of an ASF.
  - b) Investment fluctuation reserve used in conjunction with crediting rates in an ASF to smooth the impact of market fluctuations on members' account balances over a number of years.
  - c) Operational risk reserve used to hold the financial resources to meet an ASF target amount.
2. Reserves are largely concerned with contingent events and, as such, it is expected that the Trustee Board must exercise judgement in determining the need for them, their scop, size and operation.

#### 14. DOCUMENT CONTROL

<b>Document owner</b>	Chief Finance Officer
<b>File name</b>	Reserving Management Policy

#### Document version /change control

<b>Version</b>	<b>Issue date</b>	<b>Author</b>
Draft 1		Leo Kamara

#### Document Approvals

<b>Approved by (name)</b>	<b>Title</b>	<b>Signature</b>	<b>Date</b>
Anthony Smare	NSL Board Chairman		

DRAFT