



BANK OF PAPUA NEW GUINEA

**SUPERANNUATION PRUDENTIAL STANDARD
1/2004**

**AUTHORISED SUPERANNUATION FUNDS
INVESTMENTS**

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PART 1—PRELIMINARY

- 1) **Short title and commencement:** This Standard may be cited as *Superannuation Prudential Standard (ASF Investments) 2004*.
- 2) **Authorization:** The Bank of Papua New Guinea, acting under section 43 of the *Superannuation (General Provisions) Act 2000* and all other powers enabling it, determines this standard.
- 3) **Application:** This standard prescribes requirements about ASF investments and related matters. ASFs and relevant licence holders must comply with it.
- 4) **Interpretation:** In this standard, unless the contrary intention appears—
 - a. “Act” means the *Superannuation (General Provisions) Act 2000*, and regulations, other prudential standards, licences, authorities and other instruments made under or for the purposes of that Act.
 - b. “associate”, in relation to a person, means any of the following—
 - i. a relative of the person;
 - ii. a body corporate of which the person is a director;
 - iii. an employee or partner of the person;
 - iv. if the person is a company—
 1. a director of the company; or
 2. a subsidiary of the company; or
 3. a director or employee of a subsidiary of the company;
 - v. in relation to a body corporate or a trust—if the person has an agreement or arrangement with another person with respect to the acquisition, holding or disposal of shares or other interests in the body corporate or trust, or under which they undertake to act together in exercising their voting power in relation to the body corporate or trust—the other person.
 - c. “custodian” means a person that provides services generally called custody services to licensed trustees or licensed investment managers of ASFs.

Commentary

1. Custody services include services such as clearing, settlements, safekeeping of assets, investment administration and reporting to the trustees or investment managers. They do not include investment management services.
- d. “custody agreement” means an agreement between the licensed trustee or licensed investment manager of an ASF and a custodian for the provision of custody services for the ASF.
- e. “derivative” means a financial asset or liability the value of which depends on or is derived from other assets, liabilities or indexes.

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- f. “investment management agreement” means an agreement between the licensed trustee of an ASF and an investment manager for the provision of investment management services for the ASF.
- g. “market value” of an asset means the amount that it would be reasonable to expect a buyer to pay for the asset if the parties to the transaction were dealing with each other at arm’s length.

Commentary

- 1. Assets acquired for no consideration, for less than market value or for more than market value are all valued at market value. In particular, the ASF’s interest in leased property (either as lessor or lessee) is valued at the market value of its interest in the property.

Commentary on definitions

The following are defined in section 3 of the Act:

- “ASF”
- “entity”
- “group”
- “financial accommodation”
- “member”
- “property”
- “relative”.

- 5) **Market value**: For the purposes of this standard, the value of an asset of an ASF is its market value. It is irrelevant what consideration was paid to acquire the asset.
- 6) **Commentary**: Commentary in this standard is included for guidance.

PART II—STATEMENT OF POLICY

- 7) **Purpose**: This standard prescribes requirements about ASF investments and related matters.
- 8) **Scope**: All ASFs and relevant license holders must comply with this standard.
- 9) **Responsibility**: It is the responsibility of the board of directors of the Trustee Company and relevant licence holders to comply with this standard.

PART III—INVESTMENT MANAGERS AND CUSTODIANS

- 10) **Appointing investment managers**
 - a. The licensed trustee of an ASF must not advertise or seek expressions of interest for appointment of an investment manager before it has notified the Central Bank as required by section 126B of the Act.

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Commentary

1. Section 126B of the Act requires the licensed trustee to inform the Central Bank when contemplating appointing or changing investment managers. The Central Bank may then require the licensed trustee to appoint an independent probity officer, to advise the licensed trustee on matters of transparency and probity connected with the appointment, and report to the Central Bank on the appointment process.
- b. In selecting an investment manager, the licensed trustee of an ASF must—
 - i. use proper tendering and selection processes; and
 - ii. conduct all necessary and appropriate “due diligence” inquiries into proposed investment managers.
 - c. An appointment of an investment manager for an ASF must be in writing.
- 11) **Investment management agreements**
- a. The licensed trustee of an ASF must ensure that, so long as the appointment of an investment manager lasts, there is in force at all times a written investment management agreement between the investment manager and the licensed trustee that complies with the Act and this standard.
 - b. An investment management agreement must—
 - i. clearly set out the terms on which the investment manager is engaged, including the fees payable to the investment manager and how the costs and expenses incurred by the investment manager are to be borne; and
 - ii. clearly set out the functions and duties that each party is to perform; and
 - iii. require the investment manager to comply at all times with the Act and this standard; and
 - iv. clearly specify each of the following—
 1. the parameters, constraints, performance standards and benchmarks for investments and investment decisions;
 2. performance indicators for the investment manager;
 3. the ownership of and rights of access to books and records relevant to the investment management agreement;
 4. the processes for resolving disputes between the parties;
 5. the rights of each party to indemnity from the other;
 6. the term of the agreement;
 7. the rights of each party to terminate the agreement;
 8. the obligations of each party on termination of the agreement; and

Commentary

1. For subparagraph (iv)(1)—the “parameters, constraints, performance standards and benchmarks for investments and investment decisions” include the investment objectives and investment strategy for the ASF, and provide for what happens when the licensed trustee varies them.

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2. For subparagraph (iv)(4)—subsections 74 (6) and (7) of the Act require disputes about investment matters to be referred to the Central Bank.
 3. For subparagraph (iv)(5)—subsection 48 (2) of the Act says that an investment management agreement cannot derogate or diminish the responsibilities of the licensed trustee under Act.
- v. require the investment manager to report at least monthly to the licensed trustee, and specify the contents of reports; and
 - vi. require the investment manager to comply with any request for information relevant to the assets of the ASF, the investment management agreement or the ability of the investment manager to perform its obligations under the investment management agreement; and
 - vii. without limiting subparagraph (iv) (7)—entitle the licensed trustee to terminate the agreement if the licence of the investment manager is suspended or revoked.

12) Qualifications for custodians

- a. A person must not be appointed as a custodian for an ASF unless—
 - i. it is a body corporate; and
 - ii. it is a fit and proper person to act as custodian and can be relied on to perform, in a fit and proper manner, the duties of custodian; and
 - iii. each of its officers is a fit and proper person to hold his or her office and can be relied on to perform, in a fit and proper manner, the relevant duties of his or her office; and
 - iv. it conducts its business in a prudent manner.
- b. For the purposes of subsection (a), the provisions of Schedule 2 of the Act apply, changing what needs to be changed.

Commentary

1. Schedule 2 of the Act makes provision for when a person is not to be regarded as a fit and proper person, or to conduct its business in a prudent manner.
- c. A person must not be appointed as a custodian for an ASF unless the licensed trustee is satisfied that—
 - i. the total net tangible assets of the person are at least K500,000; or
 - ii. if the Central Bank approves—the person is entitled to the benefit of a guarantee of an amount not less than K500,000; or
 - iii. if the Central Bank approves—the total of the person's total net tangible assets and the amount of a guarantee to the benefit of which the person is entitled is not less than K500,000.
 - d. For the purposes of subsection (c), the net tangible assets of an entity are to be worked out in accordance with generally accepted accounting practice in Papua New Guinea.

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13) Appointing custodians

- a. In selecting and appointing a custodian for an ASF, the licensed trustee or licensed investment manager (as relevant) of the ASF must—
 - i. use proper tendering and selection processes; and
 - ii. conduct all necessary and appropriate “due diligence” inquiries into proposed custodians.
- b. A custodian for an ASF may only be appointed by the licensed trustee of the ASF or with its written consent.
- c. An appointment of a custodian for an ASF must be in writing.

14) Custodian agreements

- a. The licensed trustee and licensed investment manager of an ASF must each ensure that, so long as the appointment lasts, there is in force at all times a written custody agreement between the trustee or the investment manager and the custodian that complies with this standard.
- b. A custody agreement must—
 - i. clearly set out the terms on which the custodian is engaged, including the fees payable to the custodian and the how the costs and expenses incurred by the custodian are to be borne; and
 - ii. clearly set out the functions and duties that the custodian is to perform; and
 - iii. require the custodian to comply at all times with the Act and this standard; and
 - iv. provide for the name in which the ASF’s investments are to be held by the custodian; and
 - v. clearly specify each of the following—
 1. performance indicators for the custodian;
 2. the ownership of and rights of access to the books and records relevant to the custody agreement;
 3. in what circumstances the custodian can appoint subcustodians, and its liability for acts and omissions of subcustodians;
 4. the processes for resolving disputes between the parties;
 5. the rights of each party to indemnity from the other;
 6. the term of the agreement;
 7. the rights of each party to terminate the agreement;
 8. the obligations of each party on termination of the agreement; and
 - vi. require the custodian to report regularly, but at least once a year, to the licensed trustee and the licensed investment manager, and specify the contents of reports; and
 - vii. require the custodian to comply with any request for information relevant to the assets of the ASF, the custody agreement or the ability

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- of the custodian to perform its obligations under the custody agreement; and
- viii. without limiting paragraph (b) (v)(7)—entitle the licensed trustee or the licensed investment manager to terminate the agreement if the licensed trustee is not satisfied that the custodian meets the requirements of section 12.

PART IV—INVESTMENT OBJECTIVES AND INVESTMENT STRATEGIES

15) *Investment objectives*

- a. The licensed trustee of an ASF must formulate an investment objective for the ASF. It must record the investment objective in writing.
- b. An investment objective for an ASF must—
 - i. specify the desired investment outcome for the ASF; and
 - ii. be capable of being clearly communicated so that members can understand the investment approach of the ASF; and
 - iii. be such that the extent to which the investment objective has been met can be easily determined.

Commentary

- 1. Investment objectives must be measurable. A suitable investment objective would state a performance benchmark or a desired level of return, for example, "The Fund's investment objective is to earn, on average over a 5 year period, at least 2% above CPI". Actual results can then be easily measured against the investment objective and reported to members.

- c. In formulating and reviewing an investment objective for the ASF, the licensed trustee must seek and take into account advice from the ASF's licensed investment manager.

16) *Trustee determinations related to investment strategies*

- a. For the purpose of formulating an investment strategy, the licensed trustee of an ASF must determine—
 - i. the level of risk, and the level of volatility of returns, that it considers the members are prepared to accept in connection with investments of the ASF; and
 - ii. the desired level of liquidity for the ASF.
- b. A determination under this section must be in writing.
- c. In making a determination under subsection (a), the licensed trustee must—

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- i. have regard to all the circumstances of the ASF; and
 - ii. seek and take into account advice from the ASF's licensed investment manager.
- d. In making a determination under paragraph (a) (ii), the licensed trustee must also take into account—
- i. the amount it considers should be invested in cash or in assets readily convertible to cash; and
 - ii. the expected timing of investment income and contributions; and
 - iii. actual or contingent expenditure requirements, for example, taxation or payment of member entitlements.

17) Investment strategies

Commentary

1. Paragraph 71 (2) (f) of the Act requires the licensed trustee of an ASF to formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the ASF including, but not limited to, the following—
 - the risk involved in making, holding and realising, and the likely return from, the ASF's investments having regard to its objectives and its expected cash flow requirements; and
 - composition of the ASF's investments as a whole including the extent to which the investments are diverse or involve the entity being exposed to risks from inadequate diversification; and
 - the liquidity of the ASF's investments having regard to its expected cash flow requirements; and
 - the ability of the entity to discharge its existing and prospective liabilities.
- a. An investment strategy for an ASF must be in writing.
 - b. An investment strategy for an ASF must specify each of the following—
 - i. performance benchmarks for the returns the trustee is seeking to achieve;
 - ii. determinations under paragraph 16;
 - iii. the diversification to be maintained within asset classes and between asset classes;
 - iv. if there are to be restrictions or prohibitions on investing in assets of a particular category—what those restrictions and prohibitions are;
 - v. any restrictions on the ASF's holding investments in a single entity or group;

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- vi. any minimum liquidity standards for particular categories of investments;
- vii. factors that are peculiar to the ASF.

Commentary

1. For paragraph (b)(iii)—see subparagraph 71 (2) (f) (ii) of the Act. The Central Bank notes that diversification is generally expected to result in a lower overall level of risk to achieve a specified return. Diversification may involve spreading investments—
 - over a number of individual assets, asset classes (domestic equities, property, fixed interest, cash, international equities);
 - within each asset class, such as investing in commercial and residential property, and in long and short term fixed interest investments.
 2. The desirable level of diversification and how it is achieved will depend on the size and circumstances of the ASF.
 3. For paragraph (b)(vii)—for example, that the average age of the ASF members is over 50.
- c. In formulating and reviewing an investment strategy for the ASF, the licensed trustee must—
- i. seek and take into account advice from the ASF’s licensed investment manager; and
 - ii. take into account the following (in addition to the matters that it must take into account under paragraph 71 (2) (f) of the Act)—
 1. the membership profile of the ASF (including the ages of members);
 2. the reasonable expectations of members;
 3. the nature and expected timing of members’ entitlements;
 4. the size of the ASF;
 5. taxation considerations relevant to the ASF and to members;
 6. the likelihood of future support by employers;
 7. limitations and constraints on investments imposed by law or by some other instrument, including the ASF’s governing rules;
 8. any reports from experts or other qualified professionals;
 9. any actual or potential conflicts of interest involving the trustee, the licensed investment manager or an associate of the trustee or the licensed investment manager.

Commentary

1. In supervising ASFs, the Central Bank will look for evidence that the specific matters under the covenant in paragraph 71 (2) (f) of the Act, and under this section, have been taken into account when formulating the investment strategy. This may be demonstrated through Board minutes and by other documentation (say, reports from investment advisers) and by the actual wording of the investment strategy.
2. For subparagraph (c) (ii) (3)— In particular, the licensed trustee must take into account whether the entitlements are defined benefits or accumulation entitlements.
3. For subparagraph (b) (ii) (7)—“ethical” or environment-friendly investment rules may be examples of these limitations.

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- d. An investment strategy for an ASF must be clearly expressed, so that members and prospective members can easily understand it, and can assess the investment performance and management of the ASF.

Commentary

1. A widely used method is to set formal asset allocation ranges of minimum and maximum exposure permitted for each asset class with a benchmark for each asset class.

PART V—MAKING INVESTMENTS

Commentary

1. Giving effect to (or implementing) the strategy is a separate process from formulating it. Implementing a strategy involves considerations such as the value of ASF's assets, the expertise of the licensed trustee, the availability of appropriate advice, administrative capacity and the costs of managing investments. It may involve direct investment, indirect investment (say, through collective investments), using investment vehicles or managers or a combination of these approaches.

Division 1—General rules

18) Investments to be consistent with investment strategy

- a. The licensed trustee and the licensed investment manager of an ASF must not make an investment of the ASF unless the investment is consistent with the investment strategy for the ASF.
- b. If investments of an ASF cease to be consistent with the investment strategy of the ASF:
 - i. the licensed investment manager for the ASF must notify the licensed trustee as soon as practicable; and
 - ii. the licensed trustee and the licensed investment manager of the ASF must take appropriate steps to ensure that the ASF's investments are consistent with the investment strategy of the ASF.

19) Offshore investments

- a. The licensed trustee and the licensed investment manager of an ASF must not make an investment of the ASF in a foreign country.
- b. Subsection 19(a) does not prevent an investment that is a security quoted on a recognised stock exchange.

Commentary

Existing direct foreign investments

1. This does not require ASFs to dispose of existing direct foreign investments. The exceptions in subsection 19(b) include investments in listed equities or listed property and other trusts.

Overseas Investments and exchange control

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2. The following paragraphs do not limit how much of its assets an ASF can hold in the form of offshore investments. The purpose of the following paragraphs is to provide a more efficient way of gaining exchange control approval for offshore investments by ASF where they agree to adopt the limits described below.
3. An ASF is allowed to invest offshore 10% of assets over a 2-year period (a maximum cumulative rate of 0.42% a month to a maximum of 5% in the first year). The percentage rate is determined by reference to current fund assets and must be reported on as part of the fund's annual audited financial statements. Offshore investments are to be valued on an annual basis. The 2-year period started on 1 September 2002.
4. These arrangements only apply to those ASFs that wish to take advantage of the accelerated exchange control approval. Offshore purchases of equities for dual listed stock that are brought back onshore are not counted towards the limit (if sold offshore, funds gained must immediately be repatriated; otherwise, they would go to the limit).
5. Where an ASF is above 10% and wishes to do extend its offshore holdings, it must seek exchange control approval and have it in accordance with their investment strategy. If an ASF has invested most of its 10% funds offshore, it may keep its existing levels of offshore investments including future investment returns but not to make new offshore investments until such time as they come within the guidelines.
6. For the purposes of the calculation of the level of offshore holdings, excluded from that calculation of that limit are purchases in shares of companies that primarily operate substantially within PNG. Companies to whom this concession apply include:
 - CUE Energy;
 - HIG Highland Pacific;
 - IOC Interoil;
 - LHG Lihir Gold;
 - OSH Oil Search Limited;
 - SST Steamships.
7. However, this concession is only available where, following the purchase of the relevant shareholding, the shares become registered on the Port Moresby Stock Exchange (effectively making these investments in PNG).
8. Where a fund sells shares from the above class where they took advantage of the concession and they wish to sell them through the Australian Stock Exchange or other overseas exchange (e.g. for the purposes of liquidity), they are required to remit the sale proceeds to PNG within 5 working days of the sale.
9. The Exchange Control Department of the Central Bank have recommended that for monitoring purposes, ASFs must furnish to the Central Bank a two (2) year strategic investment plan, including furnishing monthly or quarterly reports on performance of its onshore and offshore investments against its investment strategy. The two-year strategic offshore investment plan will be an integrated part of the investment strategy of the ASF and may be submitted together with the investment strategy or separately (but still part of the overall investment strategy).
10. Exchange Control will approve offshore remittance of ASF for investment purposes subject to this two-year plan.
11. For reporting purposes and monitoring purposes, the plan must contain:
 - the investment type;
 - the total amount invested;
 - the name of the financial institution or organisation invested;
 - rates of return, or expected rates of return;
 - the terms or period of the investment programs ; and,

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- for investment that has matured whether, it will be rolled over if cash (bank instruments), redeemed or sold if shares or property unit trusts.

20) Requirement to report where large exposures

- a. The licensed investment manager for the ASF must report to the Central Bank and to the licensed trustee of the ASF if 5% or more of the value of the ASF's assets consist of investments in a single entity or a single group. The report must be made as soon as practicable after, but in any event no later than 5 days after, the licensed investment manager becomes aware of the matter.

Commentary

1. This situation could come about because the acquisition of an asset takes the ASF over the 5% limit, or because of disposals of assets, or market movements.

- b. If—
 - i. 5% or more of the value of the ASF's assets consist of investments in a single entity or a single group; and
 - ii. the ASF make a further investment in the entity or group;the licensed investment manager for the ASF must report the matter to the Central Bank and to the licensed trustee of the ASF. The report must be made as soon as practicable after, but in any event no later than 5 days after, the investment is made.

- c. A report under this section 20 must set out:
 - i. the identity of the entity or group; and
 - ii. the percentage the value of the ASF's assets that consist of investments in the entity or group (for a report required by subsection (20)(b), counting the investment); and
 - iii. for a report required by subsection (20)(b)—the reason for the investment.

Division 2—Financial accommodation

21) Prohibition on giving financial accommodation to members

- a. Except as permitted by the Act or a prudential standard, a licensed trustee, in its capacity as trustee of an ASF, must not give any financial accommodation to a member of the ASF or to a relative of a member of the ASF using the assets of the ASF.

Commentary

1. Paragraph 75 (1) (a) of the Act prohibits a licensed trustee, in its capacity as trustee, from lending money of the ASF to a member of the ASF or a relative of a member. This rule:
 - helps to prevent avoidance of the preservation rules by preventing early access to members' account balances, and
 - helps to protect and enhance the retirement benefits of members by limiting the exposure of these benefits to unnecessary risk.
2. Subsection 20(a) extends this protection by prohibiting, for example, the giving of a guarantee or other form of credit

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enhancement for the benefit of a member or a relative of a member. Subsection 90 (4) of the Act specifically authorises early access to entitlements for housing purposes, subject to a number of conditions.

- b. Subsection 21(a) does not prevent the following—
- i. payment of wages and salary to a member who is an employee of the licensed trustee, and related payments;
 - ii. payment of benefits or entitlements permitted by regulations made for the purposes of subsection 126 (2) of the Act.

Commentary

1. It is proposed that regulations under subsection 126 (2) of the Act will remove restrictions on Existing Funds and Existing Trustees (as defined in Part XVIII of the Act) paying—
 - benefits or entitlements if the right to the benefit or entitlement accrued on or before 30 June 2003 and the payment was required or permitted by the governing rules of the ASF as in force immediately before the commencement of the Act;
 - housing benefits or entitlements in respect of an application made to the trustee of the ASF before the commencement of the Act;
 - benefits or entitlements by way of funding for primary, secondary, and tertiary education in respect of an application made to the trustee of the ASF before the commencement of the Act;
 - benefits or entitlements by way of funding for medical expenses;
 - life insurance benefits or entitlements.

Division 3—Arm’s length, in-house assets and dealing with associates and related parties

22) ***Investments in associates to be arm’s length—records***

- a. The licensed trustee or licensed investment manager of an ASF must not make an investment for the ASF in an associate of the ASF, the licensed trustee or the licensed investment manager unless it has recorded in writing the reasons why it considers that the investment will be conducted at arm’s length.

General commentary on arm’ length transactions

1. Section 74 (1) of the Act requires that all ASF investments be conducted at arm’s length. Section 74 (1) applies to both trustees and investment managers, as both make investment decisions for the ASF.
2. The “arm’s length” requirement in section 74 (1) of the Act does not itself prevent investments in related parties of the ASF. (The broader investment rules in paragraphs 75 (2) (a)-(e) of the Act may prevent or limit such transactions.)
3. The Central Bank considers that an ASF conducts an investment at arm’s length if a prudent person, acting with proper regard for its own commercial and financial interests, would have done what the ASF did. The Central Bank considers that whether an investment complies with this rule must be determined in the light of all the circumstances of the investment, including—

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- whether the asking price is fair, given the expected return on the asset, the risks to which the asset is exposed and its relative liquidity; and
 - whether the projected returns of income and capital are in line with market expectations;
 - whether the investment contract adequately protects the ASF and clearly identifies the parties' rights and obligations; and
 - any valuations of the investment; and
 - whether the asset is a depreciating asset.
4. The Central Bank expects that all ASF investments will be entered into and maintained on commercial terms, or on terms that are no more favourable to the other party than would reasonably be expected if the dealing were at arm's length in similar circumstances. For example, the purchase price of an investment should be at market value (or a value more favourable to the ASF than to the other party), and the agreed or expected return from the investment should be at not less than a true market rate.

23) Investments with associates as joint tenants

- a. The licensed trustee or licensed investment manager of an ASF must not make an investment for the ASF if:
- i. the investment is made together with an associate of the licensed trustee or licensed investment manager; and
 - ii. the associate and the licensed trustee or licensed investment manager hold the investment as tenants in common; and
 - iii. the licensed trustee or licensed investment manager knows or ought to know that the associate intended to use its interest in the investment by way of security.

Commentary

1. It is imprudent for an ASF to enter into such a transaction.

24) Limit on in-house assets

Commentary

1. In-house assets restrictions in this standard are designed to help protect and enhance members' retirement benefits by limiting exposures to unnecessary risks, in particular, the risk of failure of the business activities of an employer or other related party.

- a. The licensed trustee and licensed investment manager of an ASF must ensure that, at all times during a year on a date in column 1 of the following table, the value of the in-house assets of the ASF as a percentage of the total value of the ASF's assets is no more than the percentage set out in column 2 of the table for that date.

Table

Date	Permissible limit of in-house assets as percentage of the total market value of the ASF's assets
31 December 2004	9%
31 December 2005	8%

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Date	Permissible limit of in-house assets as percentage of the total market value of the ASF's assets
31 December 2006	7%
31 December 2007	6%
31 December 2008	5%

- b. If:
- i. at 31 December 2003, the value of the in-house assets of an ASF of an ASF was more than 10% of the total value of the ASF's assets; or
 - ii. at any time thereafter, the value of the in-house assets of an ASF is more than 5% of the total value of the ASF's assets;

the licensed trustee and licensed investment manager of the ASF must notify the Central Bank of the matter as soon as they become aware of it, and consult the Central Bank on steps to ensure that the percentage of the ASF's in-house assets is reduced to the satisfaction of the Central Bank.

- c. In this section—
- i. “in-house asset” means—
 1. a loan by an ASF to, or an investment by an ASF in, a related party of the ASF or a related trust of the ASF; or
 2. an asset of the ASF subject to a lease or lease arrangement between the ASF and a related party of the ASF or a related trust of the ASF;but does not include—
 3. a life policy issued by a life insurance company licensed under the *Life Insurance Act 2000*;
 4. a deposit with an authorized institution under the *Savings and Loans (Amendment) Act 1995* or the *Banks and Financial Institutions Act 2000*;
 5. Papua New Guinea Government Notes or securities;
 6. a loan to, or an investment in, a trust that is a widely held trust;
 7. an asset declared by the Central Bank not to be an in-house asset.

Commentary

1. ASFs with in-house assets consisting of loans to related parties often agree to capitalise earnings on such loans rather than receive regular interest payments. Such capitalised interest payments may be an addition to the level of in-house assets of the ASF. Where an ASF does not receive due interest payments, and these are not capitalised, the ASF may be in breach of the arm's length rule. A factor in determining whether a breach has

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occurred may be the extent of any attempts by the trustee to secure repayment of the loan.

- ii. “employer”, in relation to an ASF, means an employer that makes employer contributions to the ASF in respect of its employees that are members of the ASF.
 - iii. “related party”, of an ASF, means any of the following—
 - 1. a member of the ASF;
 - 2. an employer;
 - 3. an associate of an employer.
 - iv. “related trust”, of an ASF, means a trust that a member or employer directly or indirectly controls, but does not include a trust where the licensed trustee or licensed investment manager of the ASF makes an investment under which a listed security is held in trust until the purchase price of the security is fully paid.
- d. For the purposes of this section, a trust is a widely held trust if—
- i. 1 or more entities have fixed entitlements to all of the income and capital of the trust; and
 - ii. more than 20 entities between them have:
 - iii. fixed entitlements to 75% or more of the income of the trust; or
 - iv. fixed entitlements to 75% or more of the capital of the trust.

For this purpose, an entity and its associates are taken to be a single entity.

- e. Without limiting paragraph (i)(7) of the definition of “in-house asset” in subsection (c), a declaration under that paragraph may be for a class of assets or a class of ASFs.

25) **Rights against associates and related parties to be enforced**

- a. Each of the licensed trustee and licensed investment manager of an ASF must enforce its rights in respect of an investment of the ASF with an entity that is:
 - i. an associate of the licensed trustee or licensed investment manager; or
 - ii. a related party of the ASF;

in the same way, and to the same extent, as it would enforce similar rights in similar circumstances against a person that was not such an associate or related party.

General commentary on Division 3

No encumbrances

- 1. Section 74 (2) of the Act requires that all ASF assets be unencumbered, and thus, not charged or used as security for financial or other obligations.

Acquiring assets from members

- 2. Paragraph 75 (1) (b) prohibit the licensed trustee of an ASF, in its capacity as trustee, from intentionally acquiring assets from a member of the ASF or a relative of a member of the ASF, unless the Act permits it. The purpose of this provision is to ensure that

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the retirement incomes policy objectives and taxation concessions of superannuation benefits are not compromised.

3. The prohibition applies to buying assets and also contributions of assets "in specie" (assets other than money). Assets means any form of property, including money, real property (such as house and land) and personal property.
4. The prohibition is not restricted to purchase, but prohibits acquisition by any means.
5. The prohibition only applies to acquisitions from the member or relative. Therefore, acquisitions occurring when 2 ASFs merge do not contravene the prohibition, because these acquisitions are from someone other than the member or a relative.

Borrowing by and financial accommodation for ASFs

6. The Act imposes borrowing restriction to help protect and enhance the retirement benefits of members by limiting the exposure of such benefits to unnecessary risk. Borrowing restrictions ensure that benefits are not directly exposed to risks associated with geared investments and, in particular, stop lenders from acquiring claims over the ASF's assets that might rank ahead of members' entitlements. Transactions that give rise to a debtor-creditor relationships are not necessarily loans or financial accommodation.
7. Under paragraph 75 (1) (c) of the Act, a licensed trustee of an ASF is prohibited from obtaining financial accommodation or maintaining existing financial accommodation. Borrowings are a form of financial accommodation.
8. Subsection 75 (2) of the Act permits certain limited financial accommodation, where—
 - it is to enable the licensed trustee to make a payment of members' entitlements as required law or the ASF's governing rules and that, apart from the financial accommodation, the licensed trustee would not be able to make; and
 - the period of the financial accommodation does not exceed 14 days (counting extensions, roll overs and other concessions); and
 - if the financial accommodation were to take place, the total financial accommodation would not exceed 10% of the value of the ASF's assets.
9. This type of borrowing should only be required in exceptional circumstances. The Central Bank expects the ASF's investment strategy will minimise the need for borrowing for this purpose. Borrowing to fund payments to members could demonstrate a lack of trustee diligence.
10. Borrowing or financial accommodation to fund acquisitions is not permitted.

Division 4—Derivatives

26) **Derivatives**

- a. The licensed trustee and the licensed investment manager of an ASF must ensure that the assets and liabilities of an ASF do not at any time include a derivative.
- b. Subsection (a) does not prevent the assets and liabilities of an ASF including:

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- i. derivatives consisting of forward purchases of currency; or
- ii. derivatives used as hedging instruments within a foreign collective investment if the derivatives are held as incidental to the ASF's interest in the foreign collective investment.

Commentary

1. Generally derivatives must not be used, whether to speculate or to minimise risk by protecting assets against changes in the market (hedging).

Division 5—Monitoring and review

27) Regular review of investments

- a. The licensed trustee and licensed investment manager of an ASF must conduct reviews of the ASF's investments to ensure that they are consistent with the ASF's investment objectives and investment strategy.
- b. The reviews must be carried out regularly, and as frequently as is appropriate having regard to the nature of the investments.

Commentary

1. The amount, complexity and type of investments will govern the frequency and style of monitoring. The Central Bank expects that such reviews will be undertaken at least every quarter.
2. If asset ranges are specified, investments must be regularly reviewed to ensure they are maintained within these ranges and that they are adjusted as necessary in the light of market movements.
3. The Central Bank expects that adequate and effective procedures will be in place to monitor direct investments in particular assets. This includes monitoring of performance to ensure that the investments remain relevant and appropriate, the receipt and recording of income and obtaining proper valuations.
4. Trustees should also ensure that adequate and effective procedures are in place to monitor indirect investments. This includes monitoring of performance to ensure that the investments remain relevant and appropriate, and the receipt of regular and timely transaction reports.

28) Regular review of investment strategies

- a. The licensed trustee and the licensed investment manager for an ASF must conduct reviews of the ASF's investment strategy to ensure that it remains appropriate to circumstances of the ASF.
- b. The reviews must be carried out regularly, and as frequently as is appropriate having regard to the nature of the investments.
- c. In conducting a review, the following must be taken into account:
 - i. all the circumstances of the ASF, including the matters specified in subparagraphs 71 (2) (f) (i) to (iv) of the Act; and

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- ii. any actual or proposed changes to the ASF or to external conditions; and
- iii. without limiting paragraphs (a) and (b)—
 - 1. relevant amendments or proposed amendments to legislation; and
 - 2. growth or decline in membership; and
 - 3. changes in membership profile; and
 - 4. changes in the general economic climate or specific markets (including financial markets); and
 - 5. changes in service providers to the ASF.

PART VI—MISCELLANEOUS

29) Crediting rates

- a. The licensed trustee of an ASF must establish and give effect to a written procedure to ensure that the rates at which investment income is credited to members' accounts are fair and reasonable as between all members, and (if there is more than 1 class of member) as between the classes.

Commentary

- 1. Generally, trustees determine amounts to be credited or debited to members at least once a year, taking into account investment returns less costs and any transfers to or from reserves. Trustees may also determine from time to time interim crediting rates to be paid upon a member's exit taking into account changes in the ASF's investment performance.

30) Record keeping

- a. The licensed trustee of an ASF must keep complete and accurate records of—
 - i. the steps it takes in selecting investment managers and custodians; and
 - ii. the steps it takes to monitor and review the performance of investment managers and custodians, and actions taken as a result of those reviews.
- b. The licensed investment manager of an ASF must keep complete and accurate records of—
 - i. the steps it takes in selecting custodians; and
 - ii. the steps it takes to monitor and review the performance of custodians, and actions taken as a result of those reviews.
- c. The licensed trustee and licensed investment manager of an ASF must keep complete and accurate records of—
 - i. the procedures adopted to monitor and review ASF investments (direct and indirect) and actions taken as a result of those reviews;
 - ii. the procedures adopted to monitor and review the ASF's investment strategy, and actions taken as a result of those reviews;
 - iii. the steps it takes in selecting agents and service providers for the ASF; and

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- iv. the steps it takes to monitor and review the performance of agents and service providers for the ASF, and actions taken as a result of those reviews.

General commentary on this standard

External compliance audit and review

1. Future prudential standards are intended to require external auditors to conduct a compliance audit of ASFs on the implementation of investment strategies. This will be in addition to the normal review functions to be undertaken by the Central Bank.

ASFPNG Technical Direction Papers

2. The Central Bank has published investment guidelines under section 47 of the Act. These guidelines are comprised in Technical Direction Papers of the Association of Superannuation Funds of Papua and New Guinea.

PART VII—CORRECTIVE MEASURES

31) Remedial measures and sanctions

If any provision of this Standard is breached in a flagrant manner that threatens the interests of ASF members or potential members, the Central Bank may pursue appropriate corrective actions and sanctions by imposing or varying license conditions of the ASF's or license holder as provided in Section 17 of the Act. If a licence holder fails to comply with this standard, the Bank may, among other things, remove or suspend the licence, or impose or vary conditions on the licence to make sure that licence holder does comply.

32) Licence conditions:

Such conditions imposed on an ASF or licence holder's licence under Section 17 may include, but are not limited to, the following:

- a. require the licence holder to take certain steps or to refrain from adopting or pursuing a particular course of action;
- b. impose limitations on the acceptance of contributions or the making of investments;
- c. prohibit the licence holder from soliciting contributions, either from members or from persons who are not already members of the ASF;
- d. prohibit the licence holder from entering into any other transaction or class of transactions; and, more generally,
- e. suspend the operation or revoke the licence of the ASF or licence holder; or
- f. suspend or require the removal of any directors, managers or chief executives.

PART VIII—EFFECTIVE DATE

- 33) Effective Date-The effective date of this Prudential Standard shall be 2 February 2004.

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- 34) **Questions and enquiries:** Any enquiries relating to this Prudential Standard should be addressed to: The Manager, Financial System Supervision Department Bank of PNG, Tel: 322-7200.

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L WILSON KAMIT, CBE
GOVERNOR