

APRA INDEPENDENT REVIEW – STRENGTHENING SUPERANNUATION MEMBER OUTCOMES

Background

APRA has undertaken an independent review regarding changes it is making to the superannuation prudential framework to strengthen outcomes for superannuation members and drive improvements in strategic and business planning and fund expenditure management. The independent review is to satisfy a similar process to that required for a Regulatory Impact Statement (RIS) as set out in the Australian Government Guide to Regulation (the Guide).¹ Its purpose is to assist APRA in making a decision on proposals aimed at strengthening superannuation member outcomes and improving registrable superannuation entity (RSE) licensees' strategic and business planning and expense management. The issues canvassed in this independent review were considered by APRA at each major decision point in the development and finalisation of the proposals.

APRA's mandate is to ensure the safety and soundness of prudentially regulated financial institutions so that they can meet their financial promises to depositors, policyholders and superannuation fund members within a stable, efficient and competitive financial system. APRA carries out this mandate through a multi-layered prudential framework that encompasses licensing and supervision of institutions. In the case of the superannuation industry, APRA is empowered under the *Superannuation Industry (Supervision) Act 1993* (SIS Act) to issue legally binding prudential standards that set out specific prudential requirements with which registrable superannuation entity licensees (RSE licensees) must comply. These standards are supported by prudential practice guides (PPGs), which clarify APRA's expectations with regard to prudential requirements.

APRA regularly reviews its regulatory regime and amends its prudential requirements as a result of a number of factors including changed legislative requirements affecting the superannuation industry, changes in risk management practices, observed weaknesses in the prudential framework, and/or to reduce potential negative impacts of emerging industry issues. APRA's changes to the prudential framework for strengthening superannuation member outcomes and to drive improvements in strategic and business planning are consistent with APRA's mandate.

Questions 1 & 2 – Assessing the problem and objectives of government action

In both its initial letter of 11 August 2017 setting out its policy proposals at a conceptual level and its December 2017 Discussion Paper (refer to Question 5 for further details on consultation), APRA outlined its concerns regarding observed weaknesses in RSE licensees' business planning and fund expenditure processes, and in the assessment and provision of quality, value for money member outcomes. While the existing prudential framework includes requirements on strategic and business planning, these are limited in focus and there are no requirements which focus on member outcomes.

The August 2017 letter noted APRA's prudential concerns, drawn from its supervisory activities as existing across the superannuation industry in the form of:

¹ *Australian Government Guide to Regulation*, March 2014.

- strategic and business planning processes that are based on unrealistic assumptions and lack adequate rigour, including use of poorly constructed indicators or key performance metrics;
- business initiatives where the link to the delivery of quality, value for money outcomes for beneficiaries appears limited or is not adequately demonstrated; and
- insufficient rigour around RSE licensee decision-making and monitoring in relation to fund expenditure, setting of fees and costs and the use of reserves.

The August 2017 letter noted in respect of member outcomes that APRA has long recommended that RSE licensees adopt a broad ‘member outcomes’ perspective in assessing the outcomes of their business operations for all beneficiaries. Beneficiaries of all products provided by an RSE licensee, not just MySuper products, are entitled to have confidence that the RSE licensee is continuing to deliver quality, value for money outcomes in their best interests.²

The December 2017 Discussion Paper outlined APRA’s consideration that RSE licensees increasingly face significant strategic challenges, including demographic changes, increasing account consolidation and an ongoing lower investment return environment. These challenges, if not appropriately responded to, are likely to compromise both the delivery of appropriate outcomes to members and the financial soundness of RSE licensees’ business operations.

The existing prudential framework was not considered adequate to address the observed weaknesses and enable RSE licensees to be strongly positioned to meet strategic challenges and therefore it was considered that regulatory initiatives were needed.³

The objectives of APRA’s proposals are to ensure that RSE licensees have appropriate arrangements in place for strengthening superannuation member outcomes, and that they effectively respond to increasing strategic challenges and safeguard the financial soundness of their business operations. APRA’s proposals will introduce more detailed and specific requirements that are aimed at ensuring the provision of sound outcomes for members and improving the rigour around strategic and business planning, and expense management and reserving. Introducing new prudential requirements will provide APRA with the ability to ensure that RSE licensees meet higher expectations in these key areas and can be held to account for their actions.

Questions 3 & 4 – Options that may achieve the objectives and impact analysis – costs, benefits and risks

Policy options to address the weaknesses in RSE licensees’ business planning and fund expenditure processes, and in the provision of sound member outcomes, and the likely net benefit of each option were outlined in the December 2017 Discussion Paper.

² APRA’s letter of 11 August 2017 ‘*Strengthening Operational Governance of RSE Licensees – Upcoming Consultation*’ is available here: <https://www.apra.gov.au/strengthening-operational-governance-rse-licencees>

³ The December 2017 Discussion Paper is available here: <https://www.apra.gov.au/strengthening-superannuation-member-outcomes>

Options	Approach
Option 1: Status quo	No changes would be made to APRA’s existing prudential requirements on strategic and business planning in <i>Prudential Standard SPS 220 Risk Management</i> (SPS 220) and no new prudential requirements or guidance would be introduced.
Option 2: New or amended prudential guidance	New or amended prudential guidance on APRA’s expectations on strategic and business planning, RSE expenditure decision-making and undertaking the proposed legislative MySuper outcomes assessment. This could take the form of amendments to existing guidance (e.g. <i>Prudential Practice Guide SPG 220 Risk Management</i>) or a new prudential practice guide.
Option 3: Update prudential framework	Update the prudential framework to introduce new requirements on strategic and business planning, including assessing outcomes to beneficiaries and RSE expenditure decision-making.

The Discussion Paper sets out APRA’s initial views of the net benefits of the three policy options, along with a preliminary analysis of the costs and benefits of each option. The analysis of costs associated with each option focused on compliance costs, that is, the direct administrative, substantive business and financial costs incurred by RSE licensees in complying with the proposed prudential requirements. Indirect costs for RSE licensees and other stakeholders arising as a consequence of regulation (or not applying regulation) were also considered.

Option 1: Status quo

Under Option 1, there would be no changes made to the prudential framework. APRA considered that there would be no additional costs from this option and RSE licensees would benefit from the cost-savings of not having to comply with additional requirements. However there would be no change in industry practices to address the issues APRA has identified as of concern.

Option 2: New or amended prudential guidance

Under Option 2, amendments would be made to prudential guidance in the areas of strategic and business planning, fund expenditure decision-making and assessing outcomes to members. APRA considers that RSE licensees who follow the amended guidance could face some additional compliance costs, particularly if the RSE licensee has weaknesses in these areas, even though the guidance would not be mandatory. However it is difficult to quantify these costs as they would depend on whether and how the industry responded in changing its practices in the areas covered by the guidance.

APRA considers that the risks of this option are that there may be little change in industry practice due to the voluntary nature of prudential guidance, and this would significantly reduce the potential benefits from an overall improvement in industry standards. APRA’s experience indicates that it is significantly more difficult for APRA supervisors to drive changes in industry practices based solely on guidance, rather than prudential standards supplemented with guidance.

Option 3: Update prudential framework

Under Option 3, there would be changes to prudential requirements through amendments to SPS 220, the introduction of a new prudential standard – *Prudential Standard SPS 225 Outcomes Assessment* (SPS 225), and the provision of new prudential guidance – *Prudential Practice Guide SPG 221 Strategic and Business Planning* (SPG 221) and *Prudential Practice Guide SPG 225 Outcomes Assessment* (SPG 225). APRA considers that Option 3 will result in a significant improvement in industry practice, compared to Option 2, by placing mandatory obligations on industry. While this option would increase the compliance costs for RSE licensees, APRA's experience is that changes to prudential standards are core to driving industry-wide changes in standards of practice. APRA has sought to minimise any burden by streamlining the requirements for adequacy of resources in SPS 220. Additionally, under new SPS 225, RSE licensees would be able to design their outcomes assessment in a manner that best meets the needs of their business operations.

As outlined in the Discussion Paper, all the options would apply to all RSE licensees. Small and/or less complex RSE licensees have the same obligations and are therefore subject to the same regulatory expectations as large, complex RSE licensees. However, APRA's prudential requirements are framed in a principles-based manner that enables RSE licensees to comply with the requirements in a manner which reflects the size, business mix and complexity of their business operations.

On balance, APRA considers that Option 3 represented the most effective policy mechanism to achieve the necessary improvements in industry practice. Option 3 was expected to have the highest costs, however, it was also expected to produce the best outcome for members. While Option 1 was expected to have nil costs, APRA considers that there would be significant risks from this approach and no obvious improvement in industry standards could be expected. The risks of issuing prudential guidance alone, as outlined in Option 2, was that there may be little change in industry practice and APRA considers that this is not likely to be sufficient to address the significant concerns identified by APRA. As a consequence, APRA considers that Option 3 will provide the greatest net benefit.

Question 5 – Consultation

APRA has undertaken two rounds of public consultation on its proposals. APRA has also engaged formally and informally with a variety of stakeholders, including individual RSE licensees and industry associations.

APRA initially outlined its proposals in conceptual form in a letter to RSE licensees on 11 August 2017, and conducted industry consultation through August and September 2017. Six public submissions were received in response to this initial consultation and APRA held three industry roundtables.⁴

The initial round of consultation resulted in a number of issues being raised, including a preference for avoiding the development of new prudential standards and the need for an outcomes assessment to be meaningful for diverse membership bases (refer to section 1.6 of the Discussion Paper).

⁴ APRA's letter of 11 August 2017 '*Strengthening Operational Governance of RSE Licensees - Upcoming Consultation*' and the public submissions are available here: <https://www.apra.gov.au/strengthening-operational-governance-rse-licences>

APRA then set out its full proposals in the December 2017 Discussion Paper '*Strengthening superannuation member outcomes*'. The Discussion Paper was accompanied by a draft amended version of SPS 220, and draft versions of the new SPS 225, SPG 221 and SPG 225.

The consultation period for the December 2017 proposals closed on 29 March 2018. Fifteen public and two confidential submissions were received in response.⁵ APRA also conducted industry roundtables in Sydney and Melbourne to discuss the proposals, and continued to conduct informal consultation with selected participants while APRA's proposals were further considered. Approximately 40 participants from across the superannuation industry attended the roundtables.

In response to the issues raised and further analysis, APRA has made a number of amendments to its proposals, including:

- co-location of the outcomes assessment with the expanded strategic objectives, business planning and expenditure requirements in *Prudential Standard SPS 515 Strategic Planning and Member Outcomes* (SPS 515) (replacing the proposed SPS 225);
- re-drafting the business planning and expenditure requirements to be less prescriptive;
- redesign of certain elements of the outcomes assessment;
- replacing the proposed guidance in the December consultation package with *Prudential Practice Guide SPG 515 Strategic and Business Planning* (SPG 515) and *Prudential Practice Guide SPG 516 Outcomes Assessment* (SPG 516); and
- delaying the commencement date from 1 January 2019 to 1 January 2020.

In totality the changes to the December 2017 consultation package represent a significant reduction in the potential compliance impact on RSE licensees under Option 3.

When the package is final, APRA will release a Response to Submissions paper outlining APRA's response to comments received from industry.

Question 6 — What is the appropriate option?

Following feedback from the December 2017 consultation, APRA revised its proposals under Option 3. Details on the revisions made are outlined below and in section 5 of this paper. Taking into account feedback received and the amendment to Option 3, APRA has reviewed the net benefits of each option.

Option 1: Status quo

Under Option 1, there would be no changes to the prudential framework and RSE licensees and other stakeholders would not incur any additional compliance costs (Table 1 below).

⁵ The December 2017 Discussion Paper '*Strengthening superannuation member outcomes*' and the public submissions are available here: <https://www.apra.gov.au/strengthening-superannuation-member-outcomes>

Table 1 – Average annual regulatory compliance costs (Option 1)

Change in costs by sector (\$m)	Businesses	Community Organisations	Individuals	Total change in costs
Total by sector	\$0	\$0	\$0	\$0

Option 2: New or amended prudential guidance

Under Option 2, new or amended prudential guidance would be issued. APRA received no information during the consultation process about the costs associated with Option 2. APRA considers that the costs for Option 2 are difficult to quantify as costs would depend on whether and how the industry responded in changing its practices in the areas covered by the guidance. RSE licensees may make significant changes to their practices in light of the introduction of the guidance. However, as guidance is not mandatory, RSE licensees may not change their practices, or may do so in incremental shifts, resulting in marginal additional costs at any point in time. Therefore, APRA has assessed the costs for Option 2 as falling in a range between nil and \$1.9m (the cost for Option 3) (Table 2 below).

Table 2 – Average annual regulatory compliance costs (Option 2)

Change in costs by sector (\$m)	Businesses	Community Organisations	Individuals	Total change in costs
Total by sector	\$0 - \$1.9	\$0	\$0	\$0 - \$1.9

Option 3: Update prudential framework

Under Option 3, new and amended prudential requirements and guidance would be issued and therefore RSE licensees would incur additional compliance costs. However, these would be offset by the benefits of a significant improvement in industry practices by introducing mandatory obligations on industry (Table 3 below):

Table 3 – Average annual regulatory compliance costs (Option 3)

Change in costs by sector (\$m)	Businesses	Community Organisations	Individuals	Total change in costs
Total by sector	\$1.9	\$0	\$0	\$1.9

APRA requested (in section 1.10 of the Discussion Paper) that interested stakeholders provide information on the compliance impact of the proposed changes and any other substantive costs. Compliance costs were defined as direct costs to businesses of performing activities associated with complying with government regulation. Respondents were asked to assess compliance costs using the Commonwealth Regulatory Burden Measure, to ensure the data supplied to APRA could be aggregated and used in an industry-wide assessment.⁶

Ultimately, none of the respondents made use of this tool, and only one respondent provided an assessment of the likely costs that would be incurred in relation to the full proposal.

APRA has not used this entity's estimate of costs as it is a highly complex entity with a number of legacy systems, and would be expected to incur higher costs than the likely average across

⁶ The Commonwealth Regulatory Burden Measure is available here: <https://rbm.obpr.gov.au/home.aspx>

the industry. In addition, it appears that this entity's estimate may include the costs associated with APRA's preliminary proposal for changes to the reporting framework, which have been deferred until a subsequent consultation. Therefore, APRA considers it is not appropriate to apply this estimate of costs across the industry as it is unlikely to be an accurate measure of the likely costs for implementing the proposed changes.

APRA has therefore estimated the likely regulatory compliance costs for the industry based on available data, including the number and complexity of RSE licensees in the industry, the estimated costs that consultants would charge for assisting entities in meeting the new requirements, and measures of staffing costs based on salaries and expected time commitments for meeting the new requirements.

APRA considers that the additional costs are appropriately measured at the RSE licensee level as this is the level at which the requirements apply. APRA has assumed that the likely cost burden will depend on the complexity of the RSE licensee, and has based its assessment of complexity on the number of RSEs under trusteeship (data indicates that this is a fair proxy for complexity as it also aligns fairly closely with other complexity indicators such as the number of investment options offered by an RSE licensee). APRA has assumed that costs will be highest for the more complex entities (those with more than 6 RSEs under trusteeship), somewhat lower for entities with medium complexity (those with between 2 and 6 RSEs under trusteeship) and the lowest for non-complex entities (those with only a single RSE under trusteeship).

As set out in Question 5 of this paper, APRA has made significant changes to the proposals under Option 3, following industry feedback and further analysis. The following changes represent a material reduction in the compliance burden under Option 3 compared to the consultation version released in December 2017:

- redesign of certain elements of the outcomes assessment;
- reduction in the prescription of the fund expenditure requirements, for example not requiring the development of an expenditure policy and development of a business case for items of significant expenditure; and
- reduction in the prescription of the business planning requirements, for example not requiring specific fee and revenue data to be included.

APRA considers that moving the proposed business planning and fund expenditure requirements from SPS 220 to new SPS 515 would be more effective in achieving APRA's objectives and reflects current industry best practice. Aligning these requirements in one standard supports APRA's view that business planning and fund expenditure processes are strongly related to the delivery of outcomes and how an RSE licensee is expected to assess member outcomes.

The net effect of all these changes is a significant reduction in the likely total compliance costs under Option 3.

APRA considers that additional costs to be incurred will arise from the member outcomes assessment as these requirements are new. Some additional costs may also be incurred by some RSE licensees in relation to the expenditure requirements, which will require more rigour in decision making and monitoring of items of significant expenditure. This will depend on current practices in this area of RSE licensees. Only minimal changes have been made to the strategic and business planning requirements, which will chiefly be the annual requirements to ensure that appropriate policies and procedures are in place and documentation is updated as required.

APRA has assumed that the highest cost will be incurred in the first year when the member outcomes assessment is developed, with a lower (stable) cost incurred in future years. Measuring member outcomes should be a relatively low cost process once the design is settled, following implementation. In future years, the design of a member outcomes assessment may need some changes prompted by changes by the RSE licensee and any future updates by APRA to guidance, however these additional costs are expected to be low. Those RSE licensees that have in place tools to undertake analysis of performance, benchmarking and comparisons across the industry, will likely experience a more significant cost reduction after the first year.

Summary of assessment of policy options:

APRA has considered its proposals under the three policy options. Considering each option and the associated costs and benefits, as well as feedback from industry, APRA’s preferred approach is Option 3.

Table 4—Summary of net benefits of each option

	Option 1	Option 2	Option 3
Compliance cost	Nil	\$0 to \$1.9m	\$1.9m
Meets APRA expectations for strengthening member outcomes, strategic planning and expenditure management	Does not meet APRA expectations	Does not meet APRA expectations	Meets APRA expectations
Overall	Nil cost but continuing APRA concerns regarding member outcomes, strategic planning and expenditure management	From nil (negligible) to a moderate cost, however, inadequate improvements are likely to be achieved in member outcomes, strategic planning and expenditure management due to the non-mandatory nature of guidance	Moderate cost, however, significant improvements are likely to be achieved in member outcomes, strategic planning and expenditure management

Under Option 1, there would be no additional compliance costs. Under Option 2, the additional costs are considered to be estimated in the range from \$0 to \$1.9m. However, these options would not achieve APRA’s objectives. Even though Option 2 introduces new or amended guidance, the guidance will not be mandatory. Accordingly, RSE licensees may not change their practices, or may do so in incremental shifts, resulting in marginal additional costs at any point in time. Under either of these options, there would be significant risks that members will continue to experience substandard outcomes and that RSE licensees’ business operations may continue to be unsustainable in the long run.

Option 3 results in increased compliance costs for industry as it introduces new prudential requirements, including a new prudential standard, accompanied by new prudential guidance. APRA has responded to industry feedback, from the August 2017 letter and the December 2017 Discussion Paper, and has revised its earlier proposals. This revision was undertaken to minimise the burden on industry, whilst still seeking to ensure the proposal will result in significant improvements in the delivery of quality member outcomes, and in RSE licensees' business planning and fund expenditure processes.

On balance, Option 3 represents the most effective policy mechanism to achieve the necessary improvements in industry practices. Changes in prudential standards are core to driving industry-wide changes in standards of practice. Issuing new prudential guidance alone (as per Option 2) is unlikely to be sufficient to address the issues APRA has identified. As a consequence, APRA considers that Option 3 provides the greatest net benefit.

Question 7 – Implementation and review

APRA anticipates release of the final prudential framework changes to strengthen superannuation member outcomes and to drive improvements in strategic and business planning and fund expenditure management in December 2018. The requirements will become effective from 1 January 2020, which will provide industry 12 months to make the changes necessary to comply with the new requirements. APRA considers this is an appropriate timeframe for RSE licensees to make the necessary changes, particularly considering that RSE licensees have been made aware of the nature of the proposed changes since APRA's August 2017 letter advising of the upcoming consultation.

As delegated legislation, prudential standards impose enforceable obligations on affected APRA-regulated institutions including RSE licensees. APRA monitors ongoing compliance with its prudential framework as part of its supervisory activities. APRA has a range of remedial powers available to it to address non-compliance with a prudential standard, including issuing a direction requiring compliance, the breach of which is a criminal offence, and imposing a condition on an RSE licensee's licence.

APRA endeavours to conduct reviews of significant changes to the prudential framework once they have been fully implemented, to assess whether the requirements have met their objectives, remain consistent with relevant international standards, and remain relevant and effective in facilitating sound risk management practices. APRA expects that it will take some time for the changes being adopted to become embedded in RSE licensees' operations, and therefore a review would be conducted after at least several years of operation under the new framework. APRA will also take action within a shorter timeframe where there is a demonstrable need to amend a prudential requirement.