



31 August 2017

TO: ALL RSE LICENSEES

ASSESSING QUALITY MEMBER OUTCOMES IN THE SUPERANNUATION INDUSTRY

As the superannuation industry continues to face significant change and heightened public expectations, it is essential that RSE licensees are continuing to act in the best interests of beneficiaries to deliver quality outcomes on an ongoing basis. Delivering quality member outcomes entails RSE licensees providing high quality, value for money superannuation products and services. That includes seeking to deliver optimal retirement benefits to fund members, and other benefits and services, such as insurance, consistent with their strategic objectives.

APRA's ongoing supervision has identified some RSE licensees that appear not to be consistently delivering quality member outcomes, leading APRA to question whether these RSE licensee's business operations are appropriately positioned for future effectiveness and sustainability in an increasingly competitive industry environment.

APRA's view is that it is not sufficient for an RSE licensee to simply comply with their legislative and prudential obligations without giving due consideration to how their RSE(s) will deliver quality outcomes for members now and into the future. As such, it is necessary and timely for all RSE licensees to review, and consider whether there is a need to enhance their approach to delivering quality member outcomes and maintaining the future sustainability of their RSEs. This would include consideration of whether insurance offerings may be inappropriately eroding member retirement benefits.

There is a wide range of measures and metrics that may be relevant for assessing member outcomes and future sustainability of RSEs and products, and the particular measures used by APRA will be reviewed and refined over time to reflect industry developments. Each RSE licensee should develop their own framework and approach for an assessment that best suits their business operations. APRA expects RSE licensees, when assessing outcomes for members of their products, to establish appropriate targets and objectives and measure performance against them. Establishing appropriate targets involves use of relevant benchmarks and, where like-for-like comparisons are possible, comparisons against peer offerings. The metrics noted below would be expected to be relevant to the vast majority of RSE licensees, but are not intended to be exhaustive.

APRA's methodology for assessing member outcomes and fund sustainability

APRA has recently completed an assessment of all RSEs under its supervision, based primarily on data provided to APRA by RSE licensees. Much of the data used by APRA in its assessment is available through APRA's statistical publications. The assessment has identified RSEs which, in APRA's view, appear not to have consistently delivered quality member outcomes in the recent past, may be unlikely to deliver quality member outcomes in the future and/or may not be sustainable into the future.

APRA's assessment considers both an RSE's historical member outcomes, as well as key indicators for future sustainability. It also incorporates APRA's supervisory knowledge of the

unique characteristics of each RSE and RSE licensee, including APRA's assessment of the adequacy of governance and risk management frameworks, strategic and business planning practices and business operations.

The metrics for APRA's assessment of historical outcomes and future sustainability include:

- net returns, on an absolute basis and relative to risk/return targets;
- costs per member for MySuper products;
- cost of insurance cover;
- administration and operating expenses as a percentage of average net assets (operating cost ratio);
- net cash flows as a percentage of average net assets (net cash flow ratio);
- net member benefit outflow ratio;
- net rollovers as a percentage of average net assets (net rollover ratio);
- trends in membership base; and
- active member ratio.

These metrics are derived from data reported to APRA under the new reporting standards introduced in 2013/14. The availability of three years of data under the new reporting framework enables APRA to undertake meaningful trend analyses as part of its assessment. APRA's assessment therefore considers the measures for the relevant periods and also the trend over the period, and in particular whether measures are improving, stable or deteriorating.

APRA's quantitative assessment of an RSE's performance considers each of the metrics on an absolute and relative basis as appropriate. Absolute performance is an indicator of both the delivery of member outcomes and future sustainability in the context of the RSE's circumstances. Assessment of performance on a relative basis assists APRA to identify outliers, based on the RSE or product ranking for each metric, and in particular to identify RSEs that are in the bottom quartile on a specific measure.

In assessing historical member outcomes of RSEs, APRA has considered net returns relative to return targets of each fund's MySuper products, operating cost ratios, and insurance costs, particularly the rate at which insurance premiums are likely to have eroded member balances. For funds without a MySuper product, assessing net returns requires consideration of product-level information.

When assessing future sustainability of an RSE, APRA considers various measures linked to potential stability or growth in membership and assets as this is relevant to the likelihood that the RSE will be able to deliver quality member outcomes into the future. Net cash flow, rollover ratios and membership trends are the key metrics used when assessing an RSE's potential future stability or growth, reflecting its ability to acquire new members and retain existing ones.

APRA's approach to assessing fund performance and sustainability serves as a starting point only, in a more holistic assessment process that includes qualitative assessments by APRA supervisors. The qualitative aspect of the assessment captures APRA supervisors' judgment

as to the robustness of an RSE licensee's strategic and business planning practices and the quality of the RSE licensee's governance and risk management frameworks.

Generally, the RSEs that APRA has identified as having concerns in respect of quality member outcomes and future prospects are those RSEs that have performed poorly on an absolute and relative basis on a majority of the quantifiable metrics. In APRA's experience, RSE licensees of these RSEs can also have inadequate strategic and business planning practices, governance and/or risk management frameworks to address the risks arising from poor performance. APRA will review its assessment of RSE licensees and their RSEs regularly.

APRA response and supervisory focus

APRA will soon write to each of the RSE licensees of RSEs identified as a result of APRA's assessment to request their respective Boards to meet with APRA to discuss our assessment. These RSE licensees will be required to develop a robust and implementable strategy to address identified weaknesses within a reasonably short period and to engage more regularly with APRA to monitor the implementation of that strategy. Where it is clear that a particular product or RSE is unlikely to be able to continue to operate in the best interests of its members, APRA expects the relevant RSE licensee to act to ensure a timely and well-managed transfer of members to another suitable product or RSE, either within the RSE licensee's own operations or those of another RSE licensee.

As part of its ongoing supervision activities, APRA will discuss its approach to assessing member outcomes and future sustainability with all RSE licensees. APRA encourages all RSE licensees to consider the approach outlined above when undertaking their own assessments, with a view to identifying focus areas for remediation or improvement.

Please contact your APRA responsible supervisor if you wish to discuss or clarify any matter raised in this letter.

Yours sincerely,

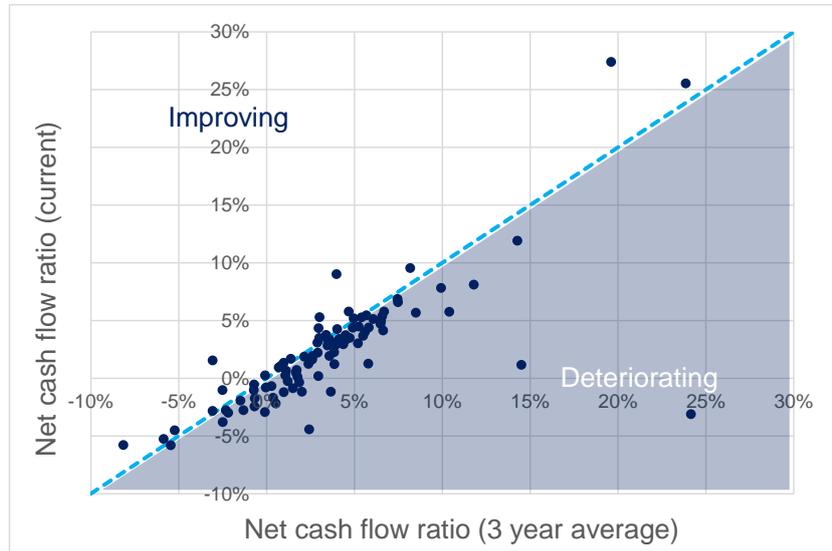
A handwritten signature in cursive script that reads "Helen Rowell".

Helen Rowell
Deputy Chairman

Attachment 1

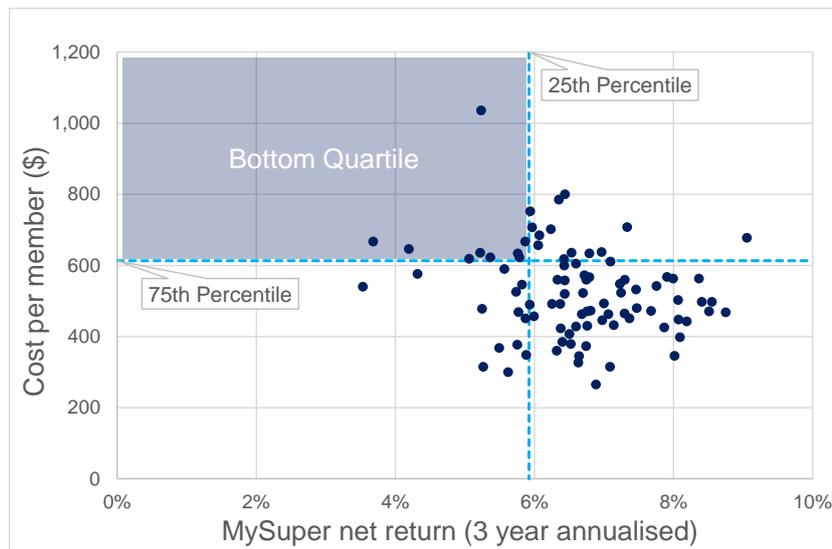
Below are four examples of stylised charts based on various metrics used in APRA's assessment of member outcomes and fund sustainability.

Chart 1



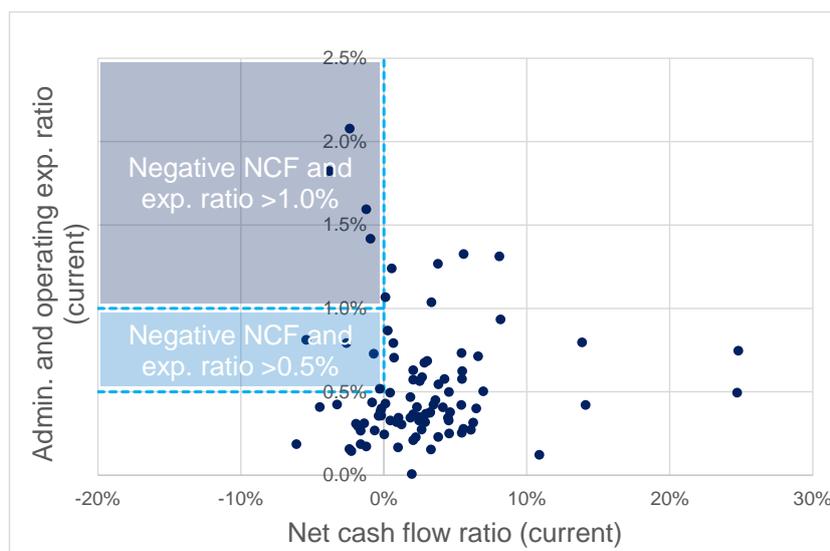
This chart shows improving and deteriorating net cash flow ratios for RSEs authorised to offer a MySuper product. The y-axis shows annual net cash flow ratio to 31 March 2017, and the x-axis shows average net cash flow ratio for financial years between 2014 and 2016. APRA will pay particular attention to RSEs where their net cash flow ratio is both negative and deteriorating.

Chart 2



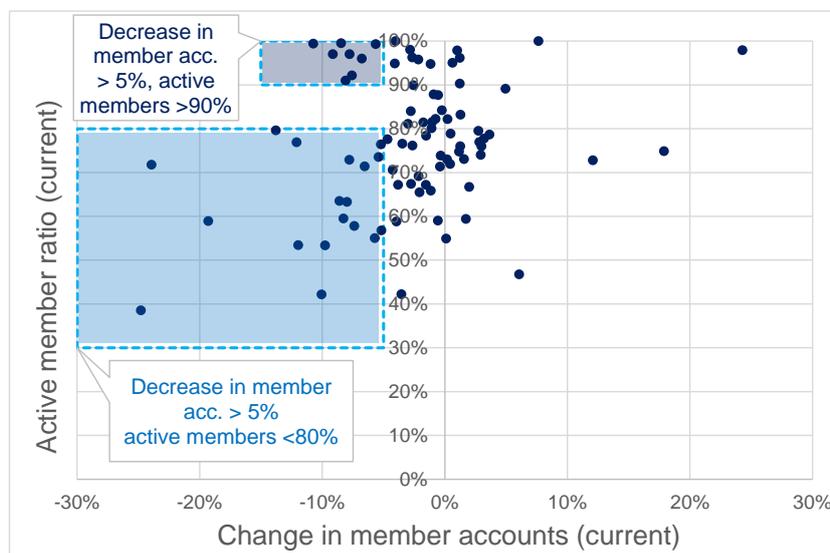
This chart represents financial outcomes for MySuper product members across different RSEs. The y-axis shows cost per member as at 31 December 2016, and the x-axis shows annualised net return of MySuper products for the three years to 31 December 2016. APRA will pay particular attention to RSEs whose net returns of MySuper products are below the 25th percentile, and with costs per member above the 75th percentile.

Chart 3



This chart shows administration and operating expense, and net cash flow ratios of RSEs authorised to offer a MySuper product. Both the y- and x-axis show annual data for the year ended 30 June 2016. APRA will pay particular attention to RSEs with negative net cash flow and high administration and operating expense ratios. Persistent negative net cash flows over time may lead to an increasing expense ratio as RSEs lose scale and fewer members absorb the same level of administration and operating costs.

Chart 4



This chart shows the level of active membership and membership growth of RSEs authorised to offer a MySuper product. Both the y- and x-axis show annual data for the year ended 30 June 2016. APRA will pay particular attention to RSEs with low levels of active membership and declining membership base, given the potential implications with respect to member retention and ability to maintain scale.