PRUDENTIAL PRACTICE GUIDE

Draft SPG 221 - Strategic and Business Planning

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Contents

About this guide

Prudential practice guides (PPGs) provide guidance on APRA's view of sound practice in particular areas. PPGs frequently discuss legal requirements from legislation, regulations or APRA's prudential standards, but do not themselves create enforceable requirements.

Prudential Standard SPS 220 Risk Management (SPS 220) sets out APRA's requirements for a registrable superannuation entity (RSE) licensee (RSE licensee) to set strategic objectives for its business operations and to maintain a written business plan that articulates an RSE licensee's approach to meeting these strategic objectives. SPS 220 also requires an RSE licensee to have robust expense management and reserving practices as part of its business planning. The guidance in this PPG relates to these requirements; guidance relevant to the requirements in SPS 220 that relate to risk management is provided separately in in *Prudential Practice Guide SPG 220 Risk Management.*

This PPG is also to be read with other PPGs related to risk management, including: *Prudential Practice Guide SPG 114 Operational Risk Financial Requirement*, *Prudential Practice Guide SPG 231 Outsourcing* and *Prudential Practice Guide SPG 232 Business Continuity Management*.

For the purposes of this guide, and consistent with the application of SPS 220, 'RSE licensee' and 'registrable superannuation entity (RSE)' have the meaning given in the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

Subject to the requirements of SPS 220, an RSE licensee has the flexibility to structure its business operations in the way most suited to achieving its business objectives. Not all practices outlined in this PPG will be relevant for every RSE licensee and some aspects may vary depending upon the size, business mix and complexity of the RSE licensee's business operations.

Glossary

APRA	Australian Prudential Regulation Authority
SPG 225	*Prudential Practice Guide SPG 225 Outcomes Assessment*
SPS 225	*Prudential Standard SPS 225 Outcomes Assessment*
SPS 220	*Prudential Standard SPS 220 Risk Management*
SPG 221	*Prudential Practice Guide SPG 221 Strategic and Business Planning*
RSE	Registrable superannuation entity
RSE licensee	Registrable superannuation entity licensee
SIS Act	*Superannuation Industry (Supervision) Act 1993*

Introduction

1. The requirements in *Prudential Standard SPS 220 Risk* Management relating to the setting of strategic objectives and business planning are designed to support an RSE licensee to deliver the outcomes it seeks for beneficiaries and to ensure the financial soundness of its business operations. SPS 220 also sets out requirements in relation to expense management and reserving, both integral components to the business planning process.

2. The need for an RSE licensee to deliver sound member outcomes has always been core to meeting their obligations to act in the best interests of their beneficiaries. RSE licensees are increasingly facing sustainability challenges as a result of, for example, an ageing membership base and potential reductions in membership and assets as benefit payments increase.

3. An RSE licensee with sound business and strategic planning processes, and rigorous decision-making processes for fund expenditure, is better positioned to respond to these challenges and deliver sound outcomes for their members.

Strategic objectives

An RSE licensee and its Board are responsible for setting strategic objectives for the licensee's business operations. The setting of strategic objectives enables an RSE licensee to determine, through its business planning process the key activities it will undertake to seek optimal outcomes for beneficiaries.

4. SPS 220 requires an RSE licensee to develop strategic objectives that must be approved by the Board. The objectives must support delivery of the outcomes that the RSE licensee seeks for beneficiaries and to ensure financial soundness of the RSE licensee's business operations.

5. SPS 220 makes clear that there must be a strong link between the outcomes being sought and the strategic objectives set by the Board. The information gathered in undertaking the outcomes assessment provides the Board with a detailed understanding of whether it is running its business operations in a manner that will enable it to provide the outcomes it seeks for beneficiaries. It is therefore important that the most recent outcomes assessment is considered by the Board when it sets its objectives and develops its business plan.

6. SPS 220 requires an RSE licensee to approve strategic objectives that ensure the financial soundness of the RSE licensee's business operations. APRA expects that, when setting objectives to address this requirement, an RSE licensee would consider all relevant information and factors, including:

   a) the financial interdependency of the RSE(s) with other entities, such as promoters or, where the RSE licensee is part of a broader group, related entities;

b) ongoing financial position and performance, including cash flow forecasts to meet the RSE licensee's liquidity, liability and operational requirements;
c) membership projections, including the active member ratio, member demographics, operating costs per member and fees charged to members;
d) changes in strategy, business plans, operating environment and other factors that might affect the risk profile of the RSE licensee and its underlying RSEs;
e) access to shareholder capital and ongoing employer sponsor financial support;
f) the sustainability and potential for innovation in products offered by the RSE(s); and
g) current and potential sources of competition.

7. When setting strategic objectives, APRA expects an RSE licensee would consider not only the financial soundness of the business operations as a whole, but also the financial soundness of the RSE(s), individual products or investment options offered by the RSE licensee.

8. APRA recognises that terminology used to describe strategic and business planning activities varies across the industry. For the purposes of the prudential framework, APRA views the strategic objectives of the RSE licensee as separate to, and supportive of, concepts such as the RSE licensee's mission statement and values, which will generally be more aspirational in nature.

Determining the objectives

9. SPS 220 requires strategic objectives to be specific, measurable and informed by an RSE licensee's legislative obligations under the SIS Act relating to insurance, investments and financial resources, the RSE licensee's risk appetite statement and annual outcomes assessment.[1]

10. When setting strategic objectives, APRA expects an RSE licensee would consider its experience in implementing previous business plans and its expectations for the future, including the operating environment and direction of the RSE licensee's operations. For example, if member growth has been negative for the last five years, objectives for future outcomes would typically consider the likelihood of a continuation of this recent trend.

11. APRA expects that an RSE licensee that is part of a larger group would set strategic objectives independently of the group objectives to ensure that priority is given to the interests of beneficiaries.[2] APRA recognises that an RSE licensee may seek to align strategic objectives with external parties that are integral to the delivery of outcomes to members, such as promoters or other associated entities.[3] In such circumstances, APRA expects that the RSE licensee would ensure that it is not bound by the objectives of external parties when setting its strategic objectives.

[1] Refer to section 52 of the SIS Act for the covenants relating to investments, insurance and financial resources and SPS 220.

[2] Refer to section 52(2)(d)(i) of the SIS Act.

[3] A reference to an 'associated entity' is a reference to an associate within the meaning of section 12 of the SIS Act; refer also to *Prudential Standard SPS 231 Outsourcing* (SPS 231) for requirements relating to outsourcing to associated entities.

12. It is important that an RSE licensee is aware of the strategic intentions of its service providers, especially where planned activities by those providers have the potential to affect the services provided to the RSE, as well as any merger plans and matters affecting business continuity arising in that provider. APRA therefore expects an RSE licensee would consider the extent to which the current and planned activities of outsourced service providers need to inform the RSE licensee's strategic objectives.

13. SPS 220 requires an RSE licensee to develop and implement a process to monitor its business plan, including whether it is likely to achieve its strategic objectives. An RSE licensee would also be expected to develop contingencies where the monitoring process identifies that strategic objectives are unlikely to be achieved. APRA does not expect an RSE licensee would amend a strategic objective solely in response to failure to meet it without undertaking analysis to determine the factors that may have caused the failure. APRA expects a key input to this process would be the result of the outcomes assessment.

14. In developing such contingencies, APRA expects that an RSE licensee would consider the circumstances in which an RSE licensee would consider a transfer of members to another RSE licensee as being consistent with its duty to act in the best interests of beneficiaries.

Linking strategic objectives and risk management

15. SPS 220 requires an RSE licensee to consider its risk appetite statement when determining its strategic objectives. APRA expects that an RSE licensee's risk appetite statement would identify the strategic and business risks of its business operations and clearly communicate its tolerances of how much risk it is willing to accept. The risk appetite statement would then inform the setting of objectives and the business planning process by focusing on the acceptability of risks associated with new business initiatives and planned business activities.

16. APRA's view is that having a risk management strategy and a risk appetite statement that are consistent with a sound business plan is fundamental to an effective risk management framework. As such, APRA expects that the risk management framework would be developed and reviewed in the context of an RSE licensee's strategic and business planning processes.

Business planning

A business plan documents the activities that an RSE licensee will undertake to achieve its Board-approved strategic objectives. A robust plan is formed from a comprehensive understanding of the environment in which the RSE licensee operates and considers the impact of differing assumptions and scenarios on the RSE licensee's financial soundness. Poor business planning may impede an RSE licensee's capacity to properly carry out its duties and its ability to deliver quality outcomes for beneficiaries.

17. SPS 220 requires an RSE licensee to have a rolling business plan of at least three years' duration that is reviewed annually. The business plan must set out the details of how the strategic objectives will be achieved. APRA expects that the business planning process would be driven by the Board and senior management and any decision-making delegations relating to the business plan would be clearly articulated.

18. The business plan must cover the entirety of an RSE licensee's business operations in a manner that reflects the complexity of those operations. It is open to an RSE licensee to develop a business plan that best suits the structure of its business operations; however, APRA expects that the level at which the business plan is set would align with the level at which the strategic objectives are set. A business plan need not be a single document but can instead be a suite of appropriate planning documents if this is more appropriate for the RSE licensee's business operations.

Developing the business plan

19. As part of the development of the business plan, an RSE licensee would typically prepare budgets, based on certain key assumptions around membership growth and expenses and profit margins. In APRA's view, a robust plan is one that is formed from a comprehensive understanding of the environment within which the entity operates and that considers the impact of differing assumptions or scenarios on the entity's financial position.

20. SPS 220 requires an RSE licensee to ensure that decisions relating to fund expenditure are consistent with its strategic objectives which, in turn, must support the delivery of the outcomes it seeks for beneficiaries and ensure the financial soundness of the RSE licensee's business operations. APRA expects decisions relating to expenditure would be largely informed by revenue forecasts determined by the fees charged to members.

21. Fees charged to members are a primary source of revenue for an RSE licensee's business operations and thus have a direct impact on outcomes to beneficiaries. SPS 220 requires an RSE licensee's business plan to detail the basis for setting the amount of fees to be charged. APRA expects an RSE licensee would consider, as part of this process, how it intends to achieve an appropriate balance between factors such as the level of margin sought and its business operations remaining competitive and financially sound. APRA therefore expects that an RSE licensee would adopt an informed and rigorous process that not only ensures compliance with the general fee rules where relevant

(including approaches to setting fees on a cost recovery basis) but also considers the impact of fees on the outcomes to beneficiaries and the ongoing viability of operations.[4]

Implementing the business plan

22. Once the business plan is approved by the Board, an RSE licensee would ordinarily ensure that responsibilities are assigned to ensure that detailed plans, including budgets, are developed and incorporated into the shorter term operational plans of the RSE licensee. It would be prudent practice for an RSE licensee to clearly articulate and regularly review the resources allocated to the ongoing implementation of the business plan.

23. In APRA's view, a key factor underpinning a successful business plan is the remuneration and incentives of those who are responsible for implementing it. As a result, APRA expects that an RSE licensee would avoid putting in place incentives that encourage outcomes that may run counter to the interests of beneficiaries. That is, actions which may be of benefit to staff, shareholders or management but which could affect the long-term viability of the entity or adversely affect outcomes to beneficiaries.

Monitoring progress

24. SPS 220 requires an RSE licensee to monitor its performance against its business plan. Monitoring of the implementation of its business plan enables an RSE licensee to identify when its plans and activities are not achieving their expected outcomes, or when the assumptions on which strategic objectives are based are no longer appropriate. Monitoring may also assist an RSE licensee to quickly identify and respond to emerging risks. APRA expects that an RSE licensee would ensure that there are appropriate staff assigned to undertake this function.

25. APRA considers the use of appropriate metrics as a core feature of tracking performance against the business plan. When deciding these metrics, a prudent RSE licensee would consider:

    a) whether the metrics can be meaningfully measured and monitored;
    b) the balance between qualitative and quantitative data underpinning the metrics; and
    c) the balance between leading and lagging metrics.

    A non-exhaustive list of relevant metrics is provided in Attachment A.

Reviewing the business plan

26. SPS 220 requires an RSE licensee to review its business plan annually. APRA expects that this review would include an assessment of the performance of the plan against pre-determined metrics and indicators.

[4] Refer to section 99E of the SIS Act and Division 5 of the SIS Act (in respect of MySuper products).

27. As part of the annual review, an RSE licensee is required to consider the findings of the most recent outcomes assessment; specifically, the changes to its business operations that the RSE licensee identifies would improve outcomes provided to beneficiaries.[5] Before proceeding with such changes, an RSE licensee would be expected to consider the costs and benefits of implementing these changes. Where the cost-benefit analysis supports proceeding with the changes, an RSE licensee should document any planned actions and timeframes for the implementation of such changes. For example, when an RSE licensee's assessment identifies areas of concern in respect of its insurance offering, APRA expects that the actions to address the concerns would be reflected in both the business plan and the insurance strategy.[6]

28. APRA also expects that the review process would usually consider the impact on the risk profile of the RSE licensee's business operations and identify the potential emergence of any new material risks. This might include formal consideration of issues arising from planned material changes to the RSE licensee's business operations and risk profile.

Expense management

The management of expenses is an essential component of business planning. Rigorous expense management practices ensure that the expenses incurred by an RSE licensee are reasonable and contribute to the RSE licensee achieving its strategic objectives. Such practices also provide beneficiaries with confidence that the RSE licensee is acting in their best interests when making a decision, even in the circumstances where the planned outcomes for the expenditure are not realised.

29. SPS 220 requires an RSE licensee to ensure that fund expenditure can be demonstrated to be consistent with its strategic objectives. These objectives must, under SPS 220, be clearly linked to delivering the outcomes the RSE licensee seeks for its beneficiaries and ensure the financial soundness of the RSE licensee's business operations.

30. APRA expects that an RSE licensee's fund expenditure policies and procedures would cover all types of expenditure, whether planned or not, and broadly includes the appropriation of member contributions not allocated to member accounts. This includes, for example, payments to outsourced providers and business planning initiatives (such as advertising and payments to parent entities, sponsoring bodies or other shareholders). It is open to an RSE licensee to maintain different processes for different categories of expenditure depending on the materiality of the amount being considered, regardless of whether an amount is being paid from the RSE or transferred to a reserve.

31. In APRA's view, when making decisions involving expenditure, the more indirect or tangential the linkage between an expenditure decision and the strategic objectives set by

[5] Refer to *Prudential Standard SPS 225 Outcomes Assessment* for the requirement to undertake a regular outcomes assessment.

[6] Refer to *Prudential Standard SPS 250 Insurance in Superannuation.*

the Board, the less likely it is that the decision will comply with the sole purpose test.[7] For example, expenditure on member education, member recruitment and member retention may be appropriate where the RSE licensee is able to demonstrate that these actions deliver tangible outputs consistent with the outcomes being sought.

32. SPS 220 requires an RSE licensee to put in place enhanced oversight for expenditure decisions that the RSE licensee considers to be significant in the context of its operations. APRA expects that significant expenditure decisions would generally be approved by the Board. Where senior management is responsible for approving expenditure, APRA expects there to be appropriate reporting regarding the decision taken and suitable monitoring to ensure that the expected outcomes to beneficiaries from the expenditure are being achieved. It is open to the RSE licensee to determine how it achieves such ongoing oversight so as to not impede the making of timely decisions and avoid reporting processes that are not overly onerous.

33. APRA expects that an RSE licensee would document the process for making significant fund expenditure decisions, so that the RSE licensee is able to demonstrate:

    a) a clear relationship between fund expenditure and strategic objectives, business initiatives and business plan targets;
    b) how decisions regarding fund expenditure are consistent with the RSE licensee's duty to act in the best interests of beneficiaries; and
    c) where fund expenditure involves using an associated entity, how the decision has been made on an arm's length basis.

34. APRA envisages that expenditure associated with specific initiatives or projects linked to the business plan such as the development of new product features or the means of offering products would ordinarily be considered to be significant.

35. APRA also considers that expenditure associated with the outsourcing of material business activities would ordinarily be significant. However, where an RSE licensee satisfies the requirements relating to expense management through compliance with *Prudential Standard SPS 231 Outsourcing*, APRA does not expect the RSE licensee to replicate the documentation for the purposes of complying with SPS 220.

[7] Refer to section 62 of the SIS Act.

Use of reserves[8]

The reserves of an RSE are typically regarded as monies forming part of the net assets of the RSE that have been set aside for a clearly stated purpose. Reserves are established for a particular risk or set of risks identified in the risk management framework. The use of reserves ultimately affects outcomes to members and therefore must be managed in a manner that is consistent with delivering sound outcomes to members.

36. Reserves are typically held by an RSE licensee to address contingent events. APRA expects that an RSE licensee would develop policies and processes to determine the need for reserves and their scope, size and management. The policies and processes would ordinarily articulate the rationale for the establishment of the reserves and ongoing objectives. APRA expects that policies and process would be comprehensive and contain appropriate objectives for which the reserve is established, as well as measures to manage the reserve.

37. Measures that APRA regards as sound reserve management include, but are not limited to:

    a) clear definition of the purpose, or purposes, of each reserve;
    b) setting the conditions for the use of reserve monies and limits on the amounts that may be transferred out of the reserve, which would include consideration of how payments from the reserve into members' accounts are made in a fair and equitable manner;
    c) determination by the RSE licensee of an appropriate target amount or range for each reserve, including how and over what period the reserves are to be initially established and replenished after a transfer from the reserve;
    d) determination by the RSE licensee of how it would respond in circumstances where a reserve has been exhausted or is insufficient to meet the cost of a contingent event, including whether, and over what period, other net assets of the RSE could be relied upon;
    e) where a reserve is specific to a particular sub-fund of an RSE, or a particular type of interest within an RSE or sub-fund, effective mechanisms to ensure that the reserve is quarantined to that sub-fund or type of interest;
    f) periodic review to ascertain that each reserve remains appropriate to the RSE's circumstances, and that controls and procedures implemented by the RSE licensee ensure that reserves are used only for the intended purpose or purposes;
    g) a process by which the RSE licensee would determine that a reserve is excess to requirements or no longer required and the process to be followed to distribute the excess;

[8] This guidance applies generally to all reserves, but does not replace the requirements set in relation to reserves maintained for the purposes of satisfying the operational risk financial requirements in *Prudential Standard SPS 114 Operational Risk Financial Requirement* or associated guidance in *Prudential Practice Guide SPG 114 Operational Risk Financial Requirement*.

h) a process for recording the balance of each reserve, the movements in and out of the reserve and the purpose of the movements where appropriate; and

i) proper recording of the reserves in the accounts of the RSE to enable reporting to the RSE licensee and to APRA as required by reporting standards made under the *Financial Sector (Collection of Data) Act 2001*.

38. APRA expects that an RSE licensee's strategy for managing reserves would address how to fairly attribute the accumulation of reserves across different cohorts of beneficiaries, including consideration of intergenerational issues. It is APRA's view that appropriate and prudent management of reserves benefit all beneficiaries of an RSE, even if the circumstances that would warrant use of the reserve do not eventuate during the membership of a particular cohort of beneficiaries.

39. Whilst reserves are monies that have not been allocated to beneficiaries, not all unallocated monies constitute reserves. Unallocated monies that are not reserves include accounting constructs such as suspense accounts used to record contributions and rollovers pending their allocation to the accounts of specific fund beneficiaries. Accrued expenses and provisions for administration expenses, taxation and management or service provider fees are liabilities of the fund arising from past events and would not be regarded as reserves for the purpose of this guidance. APRA's view is that items of this nature would not be classified as reserves for reporting purposes

40. Where an RSE licensee has an insurance premium adjustment mechanism in place, APRA expects that the proceeds of such a mechanism would be operated through a specific insurance reserve and generally only used to meet insurance premium costs (that is, such proceeds would not generally be used to provide insurance services or for any other purpose). An RSE licensee's insurance reserve policy would ordinarily ensure appropriate and timely use of the insurance reserve to adjust member premiums.

Attachment A Examples of metrics

Examples of metrics that an RSE licensee may consider using to monitor progress against its business plan, include, but are not limited to:

Financial performance indicators
• target investment performance, including net returns relative to appropriate benchmarks over the medium and long term
• target net asset growth
• target cost or expense base, including average operating costs per member and average operating costs per active member
• target fee levels
• target liquidity measurements, including net outflow ratio
• target average insurance product premiums and claim payment ratios
Membership indicators
• measures of member switching and the reasons for switching
• target levels of active and inactive members
• target levels for default employers
• understanding membership demographics, including, at a minimum, data on age, gender, account balance, retirement preferences
• targets for member engagement through various channels, including utilisation by members of different communication channels
Business initiative indicators
• outcomes of initiatives such as new/enhanced services or changes in benefits/product design and associated member take-up or other targets
Outsourcing arrangement indicators
• target performance by service providers
• target budget for outsourcing arrangements
• analysis on the availability of alternative service providers in the event of a price increase or service disruption
• analysis on the ability or potential ability of the RSE licensee to in-house functions currently undertaken by third parties

APRA