PRUDENTIAL PRACTICE GUIDE

Draft SPG 225 - Outcomes Assessment

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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 225 Outcomes Assessment (SPS 225) sets out APRA's requirements for a registrable superannuation entity (RSE) licensee (RSE licensee) to annually assess the outcomes provided to beneficiaries (outcomes assessment) and determine whether these outcomes can be improved into the future.

An RSE licensee that identifies opportunities to improve outcomes is required to consider these changes, having regard to the costs and benefits of making these changes, as part of its business planning process. Accordingly, APRA expects SPG 225 would be read in conjunction with *Prudential Standard SPS 220 Risk Management* (SPS 220) and *Prudential Practice Guide SPG 221 Strategic and Business Planning.*

In determining the outcomes being sought for beneficiaries, an RSE licensee must ensure that its RSEs are maintained solely for the purposes set out in section 62 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act). An RSE licensee must also, at all times, comply with the obligations set out in the covenants in section 52 of the SIS Act.

The guidance provided in this PPG is relevant to all areas of the RSE licensee's business operations, including the offering of MySuper products.

Subject to the requirements of the RSE licensee law (including SPS 220 and SPS 225)[1], 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.

For the purposes of this guide, and consistent with the application of SPS 220 and SPS 225, 'RSE licensee' has the same meaning given in section 10 of the SIS Act.

[1] Refer to section 10 of the SIS Act for the definition of 'RSE licensee law'.

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. *Prudential Standard SPS 225 Outcomes Assessment* (SPS 225) requires an RSE licensee to undertake an annual assessment of outcomes being provided to beneficiaries and identify opportunities for improving these outcomes. SPS 225 reflects APRA's view 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 beneficiaries now and into the future.

2. In conducting an outcomes assessment, APRA expects an RSE licensee would:

   a) articulate the outcomes it seeks for beneficiaries and the metrics it will use to measure progress;
   b) undertake an assessment of outcomes using these metrics, in absolute and relative terms;
   c) determine the impact that features of their product offering and business operations have had on the performance of its metrics; and
   d) identify and pursue opportunities for improving outcomes, where the cost-benefit assessment justifies doing so.

3. As a result of undertaking the assessment, an RSE licensee may conclude that making certain changes to aspects of its business operations would improve outcomes for beneficiaries. Such changes may include changes to the design of individual products, the range of products on offer and significant fund expenditure items. In considering whether to implement such changes, APRA expects an RSE licensee would consider the costs to beneficiaries, relative to the benefits, of making these changes.

4. Where an RSE licensee holds an authority to offer a MySuper product, SPS 225 enables an RSE licensee to incorporate the assessment performed under section 29VN of the SIS Act to satisfy the requirements under SPS 225 in respect of that MySuper product. In such circumstances, APRA expects that the outcomes assessment conducted under SPS 225 would clearly document how it has incorporated consideration of each MySuper product.

Articulating outcomes

Delivering quality outcomes to beneficiaries requires an RSE licensee to provide high quality, value for money superannuation products and services. This includes seeking to deliver optimal retirement benefits, and other benefits and services, such as insurance, to fund beneficiaries, consistent with the RSE licensee's strategic objectives.

5. SPS 225 requires an RSE licensee to detail the outcomes that it seeks to provide to beneficiaries. APRA regards outcomes as the results of the product design as experienced by beneficiaries, in contrast to the business goals or targets that an RSE licensee may set to ensure the financial soundness of its business operations. APRA

expects that there would be a strong link between the outcomes being sought and the strategic objectives set by the Board.

6. APRA expects an RSE licensee would take a broad approach to considering outcomes, including, but not limited to:

   a) returns net of investment fees;
   b) administration fees;
   c) insurance cover and costs;
   d) the nature and quality of the benefits and services being provided;
   e) the adequacy of an RSE licensee's governance and risk management frameworks and practices; and
   f) the scale of its business operations.

   Some examples of outcomes that an RSE licensee may seek include provision of a certain level of benefits in retirement, achievement of a return target over an extended time period, reducing administration and operating costs per account and insurance costs below a set percentage of contributions.

7. APRA considers that relying on RSE level net returns alone as a measure of outcomes, whether on a relative or absolute basis, is not sufficient.[2]

8. APRA's view is that it is not necessarily the case that the lowest fee structure will provide better outcomes for beneficiaries over the long term. Enhancing overall long-term outcomes by, for example, improved education and advice to support informed choices by beneficiaries or tax-effective investment management, may have a more material impact on long-term net outcomes for beneficiaries than relatively small reductions in investment or administration fees. It is open to an RSE licensee to conclude, for example, that beneficiaries would benefit from slight increases in costs where this will support appropriate investment in systems and services to enhance overall effectiveness and outcomes. Optimising insurance arrangements to appropriately balance the cost of insurance with meeting beneficiaries' needs is also a relevant consideration in terms of overall long-term outcomes provided to beneficiaries.

9. APRA expects that an RSE licensee's selection of outcomes would draw on extensive historical trends where possible and not be limited to the most recent period or periods. For example, APRA expects an RSE licensee would consider long-term data in membership, costs and fees to determine the outcomes it seeks to provide beneficiaries.

10. APRA considers it reasonable for an RSE licensee to determine different outcomes for different groups of beneficiaries depending on the nature of the products being made available to those groups. Cohorts of beneficiaries can be constructed according to, for example, whether they have made an active choice, whether they hold a defined benefit interest or whether their account is in the pension phase.

[2] Refer to Insight Article, Issue 2, 2017.

Designing the assessment

The design of an outcomes assessment affords an RSE licensee the opportunity to clearly articulate the range of outcomes being made available across their membership and that they have considered all beneficiaries within their business operations.

11. It is normal practice for an RSE licensee to offer a range of products to beneficiaries in both the accumulation and the retirement phase which are differentiated in many ways, such as risk, return or investment strategy. APRA expects an RSE licensee would design their assessment in a manner that reflects the structure of its business operations, including the range of products, investment options and sub-plans. Segmenting its business in this way enables an RSE licensee to satisfy itself as to the rigour of its assessment and ensures that the assessment of outcomes provided to different cohorts of beneficiaries is meaningful. APRA expects an RSE licensee would also take into account the complexities of its business operations when selecting the metrics it will use to measure the outcomes provided to beneficiaries.

12. SPS 225 requires that the outcomes assessment is conducted annually. APRA expects an RSE licensee would undertake the assessment within 12 months of the previous assessment, and at a point in their year of income that enables the outcomes of the assessment to be reflected in the annual review of the business plan.

13. APRA expects that an RSE licensee's outcomes assessment would evolve over time. APRA therefore encourages each RSE licensee to re-evaluate their process for undertaking the assessment with a view to ensuring that it remains relevant given any changes to their business operations or factors in the external environment since the assessment was last undertaken.

Segmenting the business operations

14. Assessing outcomes at the segment level, rather than the fund as a whole, may assist an RSE licensee to better understand the performance of their operations. For example, it can be difficult to identify underperformance of a particular sub-plan or investment option when overall outcomes at the fund level appear sound. Segmentation also enhances the ability of an RSE licensee to benchmark its performance and identify and investigate industry trends and emerging issues.

15. APRA expects an RSE licensee would consider whether segmenting its business is appropriate – whether at the fund, product, sub-plan or any other suitable grouping. Where this approach is adopted, APRA expects an RSE licensee would be able to provide the rationale for the different segments. An RSE licensee is free to determine the most appropriate segments for its business operations, as long as it is satisfied that all beneficiaries are covered. APRA expects that an RSE licensee that has determined separate outcomes for different groups of beneficiaries would reflect these groupings in the RSE licensee's design of its assessment. An RSE licensee's decisions regarding

which segments to select would have regard to the availability of data for each segment type for comparability purposes. This will enable an RSE licensee to more closely examine the performance of different segments across its operations.

16. An RSE licensee that elects to segment its RSEs is not precluded from grouping homogeneous groups, such as sub-funds with similar investment, insurance or demographics, for the purposes of the assessment, as long as the selected groupings enable meaningful comparison.

Selecting metrics

17. SPS 225 requires an RSE licensee to detail the metrics that it will use to measure the outcomes provided to beneficiaries.

18. Depending on the outcomes that an RSE licensee seeks for beneficiaries, APRA expects an RSE licensee would consider using various metrics, including but not limited to:

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

19. Metrics that are relevant to potential future stability or growth of an RSE licensee's business operations, and thus connected with the RSE licensee's ability to take advantage of fund scale, include net cash flow, rollover ratios and membership trends.

20. Where an RSE licensee offers a MySuper product, APRA's view is that key outcomes metrics would include net returns relative to return targets for each fund's MySuper products, operating cost ratios, and insurance costs (particularly the rate at which insurance premiums are likely to have eroded account balances). APRA expects an RSE licensee would consider similar metrics when considering outcomes across all products, MySuper or otherwise.

Investments

21. Assets generating earnings at the RSE level may represent a combination of the assets held for MySuper products, choice investment products, pension products and fund reserves. These different segments typically have different investment strategies, and hence asset allocations, that reflect their different purposes and risk/return targets. Such segments are also likely to have different fees and costs. Accordingly, APRA expects that the methodology set by the RSE licensee to identify the measures of outcomes would, at a

minimum, demonstrate consideration of different return objectives, risk profiles and liquidity requirements to reflect the range of options with that may exist within an RSE.

Insurance

22. APRA recognises the challenges inherent in developing measures of outcomes relating to insurance costs and products due to the unique nature of products and premium structures negotiated between an RSE licensee and an insurer. As such, to manage these challenges, APRA expects that an RSE licensee would maintain an up-to-date view of its membership demographics, including the number of part time workers/casual workers/unemployed workers and their occupations to allow it to improve the appropriateness of its insurance offering. To address some of these challenges, an RSE licensee may also consider the design of the product and its related costs by cohort.

23. Broader industry benchmarks may serve as an important guide in assessing the impact of insurance on beneficiaries. For example, the percentage of superannuation guarantee contributions that are taken up by insurance premiums and costs may serve as an appropriate proxy measure for erosion of balances.

Undertaking the assessment

An RSE licensee, at the conclusion of its outcomes assessment, is expected to be able to determine whether any aspect of its business operations is likely to prevent it achieving the outcomes it seeks for its beneficiaries and whether it is able to improve those outcomes.

24. SPS 225 requires an RSE licensee to calculate each of its metrics and compare its results against its own benchmarks and targets (absolute basis), and to compare these results with objective benchmarks and targets and to the outcomes being sought and provided by other RSEs (relative basis). Absolute performance is an indicator of the delivery of outcomes against the RSE licensee's expectations. Assessment of performance on a relative basis assists the RSE licensee to identify, with reference to how its RSE or product compares with others in the market, whether its experience is broadly in line with industry practice.

25. APRA expects that an RSE licensee would develop a methodology for undertaking the comparison, including how the selection of measures, benchmarks and peer groups enables an objective comparison. In conducting this comparison, APRA expects the RSE licensee would access external sources of information, including those produced by independent ratings agencies and APRA's statistical publications. An RSE licensee's methodology may include simple comparisons of particular indicators or more sophisticated modelling techniques able to incorporate multiple factors. It may also consider both 'point of time' analysis and a longitudinal review, the latter being particularly useful for highlighting trends consistent with the long-term nature of superannuation.

26. Applying multiple metrics, weighted by significance, to measure outcomes is a widely accepted practice across the industry and may assist an RSE licensee's assessment. For example, some RSE licensees apply varying weights to a number of categories of outcomes including investment performance and process, administration, governance, the cost and level of insurance and advice to beneficiaries.

27. When selecting peer groups, APRA expects an RSE licensee would identify peers that will minimise comparison bias. This necessitates considering peers from across the superannuation industry, and not limiting the peer group solely on size, sector type or profit status. In general, APRA expects that the cohorts for comparison selected by an RSE licensee would vary depending on the measures being considered and the degree to which comparable information is publicly available.

28. Even where an RSE licensee's metrics compare favourably to objective benchmarks and the performance of other RSEs, APRA expects an RSE licensee would assess whether it is able to improve on these outcomes.

Explaining the results of the comparison

29. As part of its outcomes assessment, an RSE licensee must explain the results of the comparison. In simple terms, this requires the RSE licensee to form a view on the scope and quality of the outcomes provided to beneficiaries, for the costs and charges incurred in their offering.

30. Where a comparison indicates that an RSE licensee is underperforming across a range of metrics, APRA expects an RSE licensee would diagnose and explain the cause of the underperformance, namely whether services offered to beneficiaries, investments, insurance, scale of the RSE's business operations, fund expenditure and any other factor identified by the RSE licensee are the reason behind the failure to deliver quality outcomes.

Investment strategy

31. An RSE licensee must ensure that it has an investment strategy that complies with section 52(6) of the SIS Act and that, in relation to that strategy, it complies with the requirements in *Prudential Standard SPS 530 Investment Governance*. These together require an RSE licensee to implement a sound investment governance framework to manage investments in a manner consistent with the best interests of beneficiaries.

32. SPS 225 requires an RSE licensee to identify and document whether its activities in regards to its investment offering could be adjusted in a manner that delivers an improved investment outcome for beneficiaries. This may take the form of, for example, an adjusted risk target, a reduction in investment fees and costs or a change in asset allocation.

33. When undertaking its outcomes assessment, APRA expects an RSE licensee would review the investment options made available to beneficiaries, giving consideration to whether it is in the best interests of beneficiaries to continue to offer the existing

selection of investment options. APRA expects that this review would include assessment of the number and type of investment options and the take-up of rates of options and include the thresholds for when an RSE licensee considers an option to not be viable. This would include where the scale of an investment option means that the desired outcomes for beneficiaries in that option are not being provided.

Insurance strategy

34. An RSE licensee must ensure that its offering of insured benefits complies with section 52(7) of the SIS Act and requirements in *Prudential Standard SPS 250 Insurance in Superannuation*. These together require an RSE licensee to implement an insurance management strategy to ensure that insured benefits offered are consistent with the best interests of beneficiaries and do not inappropriately erode retirement outcomes.

35. SPS 225 requires an RSE licensee to identify and document whether its activities related to its insurance strategy could be adjusted in a manner that would improve insurance outcomes for beneficiaries. In APRA's view, an RSE licensee would undertake analysis of sufficient detail to support the view that the cost of the RSE's insurance offering does not inappropriately erode beneficiaries' benefits. APRA expects that such an analysis would be based on an appropriate level of segmentation of the membership of RSE and types of insurance benefits offered to beneficiaries and their cost. This analysis may incorporate affordability measures determined by the RSE licensee and/or benchmarking to comparable funds. APRA expects that the RSE licensee would carefully consider the results of this analysis and take appropriate action which may take the form of, for example, a reduced level or type of cover for different classes of beneficiaries or changing to a new insurer at the next available opportunity. APRA expects an RSE licensee would review the process that enables beneficiaries to opt out of insurance cover or increase the level of their cover and review the documentation for beneficiaries addressing insurance to ensure that beneficiaries are aware of cover restrictions and exclusions.

Options, benefits and facilities

36. The options, benefits and facilities offered to beneficiaries, including the mechanism for offering the product, are the result of an RSE licensee's decisions regarding product design and may affect outcomes provided to beneficiaries.[3]

37. Beneficiaries are generally charged for a range of services, specifically relating to investment, administration, engagement and communications, as well as the cost of managing the business operations. Services provided to beneficiaries may include fund secretarial services, access to call centres, education, intra-fund advice (where made available), the capacity to make death benefit nominations, online account information and other services that may be provided by an RSE licensee.[4]

[3] Refer to s. 29TC(1)(b) for the requirement to ensure that all beneficiaries in a MySuper product are entitled to access the same options, benefits and facilities.

[4] Refer Explanatory Memorandum Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011.

38. APRA expects an RSE licensee would determine the extent of the impact of the cost of these services on outcomes to beneficiaries. As such, an RSE licensee may choose to consider the costs of comparable services used by similar RSEs, where this information is available to determine if there are comparable services available on the market for a materially different cost.

Scale

39. SPS 225 requires an RSE licensee to consider the impact of its scale on its metric calculations and thus the outcomes being provided to beneficiaries. APRA considers that there are several benefits that can flow from scale within RSEs, including:

    a) the ability to spread fixed costs over a greater number of accounts;
    b) the ability to overcome particular operational barriers that are faced by smaller entities, such as investing in particular asset classes that require large scale investments;
    c) greater bargaining power with service providers, particularly administrators; and
    d) the ability to attract and retain higher quality staff.

    Scale also provides the opportunity to pool risk, which is particularly important in the context of retirement income products that provide longevity insurance.

40. APRA's view is that scale, in and of itself, does not guarantee better outcomes for beneficiaries; rather, the management by an RSE licensee of its scale and the efficiencies derived from its scale are key drivers behind the delivery of quality outcomes. For example, a large fund that is run inefficiently (and is therefore more expensive to operate) is likely to deliver poorer outcomes to beneficiaries than a smaller fund that is run efficiently and is therefore less costly to run.

MySuper products

41. Section 29VN of the SIS Act places a specific obligation on RSE licensees authorised to offer a MySuper product *to make a single, annual determination on whether the financial interests of beneficiaries that hold the MySuper product are being promoted having regards to the options, benefits and facilities offered under the MySuper product, and the appropriateness of the investment strategy, insurance strategy and insurance fees.*[5]

42. An RSE licensee is permitted to use any part of its determination conducted under section 29VN to satisfy the requirements under SPS 225. In doing so, the assessment conducted under SPS 225 must clearly demonstrate how the requirements of section 29VN have been satisfied.

[5] Refer to Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017 for proposals to amend the existing scale test in s. 29VN(b) of the SIS Act. This guidance will be updated once the final position on these proposals is known.

Connecting outcomes and business planning

The outcomes assessment has an integral role in informing the strategic objectives and business plan that the Board sets under SPS 220. The undertaking of the assessment, and its findings provides the Board a detailed understanding of whether it is running its business operations in a manner that will enable it to provide the outcomes it seeks to beneficiaries. It is therefore important that any changes needed to improve outcomes are considered in the business planning process.

43. An RSE licensee is required to develop strategic objectives support the delivery of the outcomes the RSE licensee seeks for beneficiaries, in addition to, ensuring the financial soundness of the RSE licensee's business operations.[6]

44. SPS 220 therefore makes it 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 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 in setting its objectives.

45. An RSE licensee's outcomes assessment may cause it to conclude that making certain changes to aspects of its business operations would improve outcomes for beneficiaries into the future. SPS 225 requires the RSE licensee to consider whether to implement these changes as part of the annual review of its business plan, where the benefits relative to the costs justify doing so. Where changes are to be implemented, APRA expects an RSE licensee would document, as part of the annual review, the details of the actions to be taken and timeframes for the implementation of the actions.

46. The findings of the outcomes assessment are also required to inform the strategic objectives set by the Board.

47. An RSE licensee that has appropriate scale within its business operations could also consider whether there is potential to negotiate lower costs, even if the costs they pay are the market standard for schemes of a similar size. It is open to an RSE licensee to conclude that seeking improved outcomes that incur higher costs initially, for example, an investment in technology to help simplify or standardise a particular service, is appropriate if it will ultimately result in reducing costs in the longer term and will not unfairly disadvantage any particular group of beneficiaries.

48. Other actions an RSE licensee may determine could improve outcomes include:

   a) closing or merging inefficient or under-used products;
   b) re-tendering for services;
   c) simplifying, standardising or removing particular services;

[6] Refer *SPS 220 Risk Management*.

d) obtaining a scale-related discount, for example to reflect an increase in the RSE's size, membership or assets; and
e) reducing a particular fee, cost or other charge.

49. In the circumstances where an RSE licensee's measures of outcomes consistently underperform in either absolute or relative terms, APRA expects the RSE licensee would actively consider whether to continue to operate the RSE(s) in its current form is consistent with the RSE licensee's obligation to act in the best interests of beneficiaries.

50. Where an RSE licensee decides to undertake a merger or wind-up, APRA expects the RSE licensee would implement a timely exit strategy that complies with the relevant legal obligations and reflects the guidance provided in *Prudential Practice Guide SPG 227 Superannuation Transfers, Mergers and Wind-ups*.