RESPONSE TO SUBMISSIONS

Strengthening superannuation member outcomes

December 2018

Contents

Executive summary

Following extensive consultation, the Australian Prudential Regulation Authority (APRA) has finalised the proposals that were set out in its discussion paper *Strengthening superannuation member outcomes* (Discussion paper), released on 13 December 2017. The final package includes:

- new *Prudential Standard SPS 515 Strategic Planning and Member Outcomes;*
- amendments to *Prudential Standard SPS 220 Risk Management*;
- new *Prudential Practice Guide SPG 515 Strategic and Business Planning*; and
- new *Prudential Practice Guide SPG 516 Outcomes Assessment*.

APRA's work on member outcomes – both the prudential policy changes covered in this paper and ongoing supervisory attention – are aimed at ensuring that RSE licensees rigorously assess their performance in terms of the outcomes they are providing their members and continually strive to improve those outcomes. The package represents a continuation of a shift in regulatory philosophy for the superannuation industry, from being substantially compliance-focused to the principles-based, outcomes oriented approach enabled by the new and enhanced prudential requirements. APRA's new requirements are designed to ensure that RSE licensees are equipped to respond to strategic challenges, and soundly and prudently manage their business operations while improving their superannuation products and options, performance and outcomes for all members.

This package complements and supports APRA's supervisory focus on a number of RSE licensees that have been identified as having room to improve on the outcomes being delivered to members, with a particular emphasis on those that have been identified as performing poorly in a number of areas. APRA's engagement with poorly performing RSE licensees is focused on determining the cause of shortcomings and then requiring them to develop a robust and implementable strategy to address these weaknesses within a short period. The new prudential requirements formalise these expectations - that all RSE licensees take a rigorous approach to assessing outcomes and identifying areas for improvement.

Specifically, RSE licensees will be expected to meet strengthened requirements for strategic and business planning requirements, including management and oversight of fund expenditure. A core component of the new requirements is the introduction of an annual outcomes assessment to be undertaken as part of an RSE licensee's business planning cycle. The assessment requires RSE licensees to annually benchmark and evaluate their performance in delivering quality outcomes to all members – covering members of both MySuper and choice products.

APRA's final package is the culmination of extensive industry engagement since August 2017, resulting in key changes to the proposals that seek to encourage RSE licensees to meet the intent of the requirements, and not view their implementation as merely a compliance exercise. Further details on the consultation process and changes are described in this paper.

There is currently legislation before Parliament that would, if passed, introduce a legislated outcomes assessment. APRA's requirements are consistent with the outcomes assessment proposed in the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No.1) Bill 2017* (the Bill). APRA will review whether any changes are needed to the prudential standards and guidance to maintain consistency with the Bill, if and when it is passed.

The new prudential requirements will take effect from 1 January 2020. A timeline of key milestones is provided in Chapter 5. RSE licensees will need to prepare well in advance, in order to meet the new requirements from the start of 2020.

APRA expects RSE licensees to continually review and enhance their approach to meeting the new prudential requirements, to ensure it remains fit for purpose. APRA's supervision of these new requirements will initially focus on how effectively RSE licensees have embedded them into their business operations and practices, and the progress of RSE licensees in delivering improved outcomes for members. APRA expects to periodically review and update the prudential guidance to reflect better industry practices that emerge over time.

Finally, in relation to the reporting proposals canvassed in the December 2017 discussion paper, APRA will be conducting further work to assess the scope and timeframes for amendments to the reporting collection. This work will consider the outcomes of APRA's post-implementation review of the prudential framework, the Productivity Commission's final report on its review of superannuation (due December 2018), and the Royal Commission's final report (due February 2019).

Chapter 1 - Introduction

1.1. Background

In recent years, APRA has intensified its supervision of RSE licensees that are not consistently delivering quality member outcomes or that may be unlikely to deliver quality outcomes in the future. While this supervisory activity is expected to result in improvements and remediation for a subset of RSE licensees in the short term, the proposed prudential framework changes seek to drive long-term improvements in industry-wide practices. The changes to the prudential framework accompanying this response paper are intended to complement and support this supervision work.

On 13 December 2017, APRA released a discussion paper *Strengthening superannuation member outcomes* (Discussion paper) and draft amendments to *Prudential Standard SPS 220 Risk Management* (SPS 220) and new draft *Prudential Standard SPS 225 Outcomes Assessment* (SPS 225). Broadly, the key proposals released for consultation were:

- expansion of the strategic objectives and business plan requirements in draft SPS 220;
- introduction of fund expenditure requirements in draft SPS 220, including the concept of 'significant expenditure' and the requirement to prepare a business case for any items of significant expenditure;
- requirement for an RSE licensee to annually assess the outcomes provided to members and identify areas for improvement under draft SPS 225; and
- where the outcomes assessment identifies areas for improvement, the RSE licensee under draft SPS 225 would be required to consider the costs and benefits of making any changes and reflect this in the annual review of the business plan.

Accompanying the discussion paper APRA also issued proposed guidance in draft *Prudential Practice Guide SPG 221 Strategic and Business Planning* (SPG 221) and draft *Prudential Practice Guide SPG 225 Outcomes Assessment* (SPG 225).

1.2. Feedback from consultation

APRA undertook extensive consultation on its proposals which were first outlined in conceptual form in a letter to RSE licensees on 11 August 2017 and later followed by consultation on these proposals through August and September 2017. The proposals released for consultation in December 2017 reflected feedback from this initial round of consultation.

APRA received submissions from a wide range of industry stakeholders on the December 2017 consultation package, including RSE licensees, service providers and industry bodies. A total of 17 submissions were received, 15 of which are publicly available on APRA's website.[1] APRA also conducted three industry roundtables in Melbourne and Sydney as an opportunity

[1] Submissions are available at: http://www.apra.gov.au/Super/Pages/Strengthening-Member-Outcomes-Submissions-Apr18.aspx

for interested parties to provide informal feedback on APRA's proposals. Approximately 40 stakeholders from across the superannuation industry attended these roundtables.

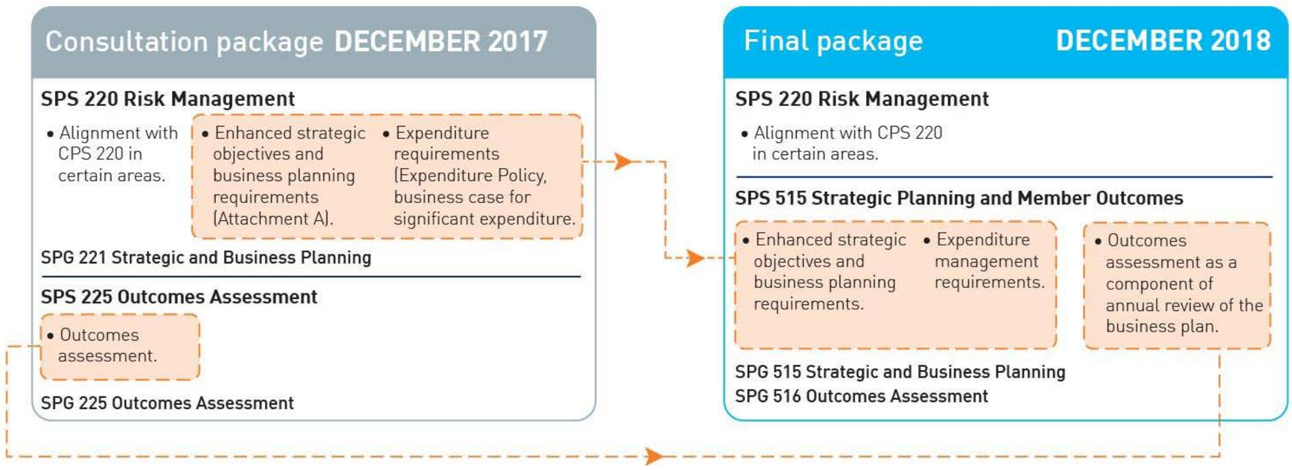
Generally, industry stakeholders were supportive of the intent of the proposed changes. However, concerns were raised regarding the level of prescription proposed in some areas and some aspects of implementation.

APRA has summarised the key issues raised in submissions and APRA's response in each of the chapters of this response paper, including the amendments to its consultation package, as set out below:

- co-location of the outcomes assessment requirements 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 of the business planning and expenditure requirements to be more principles-based;
- changes to certain elements of the outcomes assessment; and
- revisions to the proposed guidance in the December 2017 consultation package (now set out in *Prudential Practice Guide SPG 515 Strategic and Business Planning* (SPG 515) and *Prudential Practice Guide SPG 516 Outcomes Assessment* (SPG 516)).

A summary of the final requirements, including changes to existing guidance is provided in Attachment A. The structural changes between the December 2017 consultation package and the final package released in December 2018, are outlined in Figure 1.

Figure 1: Structural changes – comparison of consultation package to final package



1.3. Commencement

The commencement date of amended SPS 220 and new SPS 515 is 1 January 2020. This provides a full 12 months for RSE licensees to develop and execute an effective implementation strategy.

Key APRA expectations of RSE licensees in planning, designing and implementing the new requirements are provided in Chapter 5.

1.4. Structure of this paper

Chapters 2 and 3 summarise the main issues raised in submissions, along with APRA's responses.

Chapter 4 discusses other matters raised in submissions and minor amendments to the prudential framework.

Chapter 5 discusses implementation of the new requirements.

Chapter 2 – Business planning and fund expenditure requirements

This chapter sets out APRA's response to key matters raised during consultation in relation to the proposed business planning and fund expenditure requirements.

2.1 Enhanced business planning requirements

The December 2017 consultation package proposed a number of enhancements to the strategic and business planning requirements in SPS 220, including that an RSE licensee's business plan sets out:

- details of the activities that will be implemented to achieve the board's strategic objectives and the expected outcomes of the activities;
- the key performance indicators against which the outcomes of the activities will be reliably measured;
- the forecast revenue from fees charged to members and the basis for setting the level of fees;
- how the RSE licensee will apportion fee revenue to, where applicable, reserves, profit, dividend payments and expenses for the RSE licensee and its RSEs; and
- the assumptions used in the business plan that reflect due consideration of material risks, and evidence that these assumptions are monitored.

Comments received

A number of industry stakeholders questioned the location of the enhanced requirements for strategic and business planning within draft SPS 220. It was suggested that whilst there is a link between addressing strategic risk and having sound business planning practices, the location did not reflect industry practice, where such planning is a core function of the Board. Furthermore, APRA's objective that the outcomes assessment inform the business plan may be undermined by suggesting business planning is part of the risk management function.

Additionally, a common issue raised was that the proposed expanded business planning requirements in draft SPS 220 were overly prescriptive. Industry stakeholders considered that APRA could address weaknesses in business planning in these areas through expanding prudential guidance.

APRA's response

Location of business planning requirements

APRA agrees that the strategic and business planning process is a key function of the Board and senior management to not only assess performance over the previous period but also to guide the future direction of the RSE licensee. Accordingly, APRA has relocated the prudential requirements associated with the setting of strategic objectives and undertaking business planning from SPS 220 to a new SPS 515. APRA has retained in SPS 220 the requirement to manage risks associated with the strategic objectives and business plan through the risk management framework. As fund expenditure is closely linked to business planning, these requirements have also been relocated to SPS 515.

APRA considers that this structure will support strong alignment between the outcomes assessment and the business planning process. This will facilitate the outcomes assessment being viewed as not simply a compliance exercise but rather, an integral consideration in assessing performance against the business plan.

APRA has also sought to strengthen the focus on member outcomes by expanding the factors to be considered in the setting of strategic objectives to also include the outcomes the RSE licensee seeks for its members and also the results of current and prior outcomes assessments. This reflects APRA's expectation that the RSE licensee's strategic objectives are closely interconnected with the RSE licensee's delivery of outcomes to members.

Business planning requirements

In response to industry feedback, APRA has removed some of the prescriptive business planning requirements. APRA has commensurately expanded its guidance in SPG 515 to clarify that information on budgeting for the coming periods will form the basis of the RSE licensees' financial projections in the business plan and the assumptions that underpin these projections. SPG 515 also sets out APRA's expectation that where appropriate, RSE licensees will detail their business plan initiatives and have separate decision making processes if warranted.

SPS 515 broadens the use of key performance indicators for monitoring performance against the business plan as a whole. APRA expects RSE licensees will have in place a comprehensive approach to monitoring and assessing performance of the entire business plan. The assessment of the performance of the business plan links directly to the outcomes assessment under SPS 515 and the RSE licensee's analysis of its performance in delivering quality outcomes for members.

2.2 Expenditure policy and significant expenditure

In its discussion paper, APRA outlined the need for improvement in industry practice in the governance and oversight of fund expenditure.

Draft SPS 220 proposed that an RSE licensee develop and maintain an expenditure policy that supports rigorous decision-making, monitoring and oversight of expenditure decisions and demonstrates how expenditure is linked to the delivery of cost-effective, quality outcomes. APRA also sought to ensure there was a comprehensive and documented decision-making process around items of significant expenditure and that these were clearly linked to the delivery of member outcomes. APRA proposed that where an RSE licensee decides that a certain type or level of expenditure is significant, it would be required to prepare a business case to support the expenditure.

Comments received

Industry stakeholders submitted that the proposed expenditure management requirements were overly prescriptive and in some circumstances, such as where the RSE licensee is part of a broader group, would not necessarily capture the intended expenditure being targeted by APRA.

Industry stakeholders considered that the proposed expenditure policy requirement would result in the duplication of existing policies and processes.

A number of stakeholders expressed concerns about the proposed requirement to prepare a business case associated with items of significant expenditure. Industry stakeholders considered the proposed components of the business case overly prescriptive and not consistent with how many RSE licensees undertake spending decisions. Stakeholders also suggested that the proposed requirements potentially duplicated the existing requirements under *Prudential Standard SPS 231 Outsourcing* (SPS 231). Stakeholders also sought clarity on the types of expenditure APRA expected to be included under the concept of 'significant expenditure'.

A small number of comments noted that APRA should confirm that the significant expenditure requirement is limited to expenses attributed to an RSE or RSE licensee and recovered from members' accounts; that is, that APRA was not intending to include expenditure incurred at a group level, such as for plant and equipment or staffing costs, that has no effect on account balances.

APRA's response

APRA has streamlined the expenditure requirements in SPS 515, consistent with the intended principles-based approach. APRA has removed the requirement to have an expenditure policy in SPS 515, recognising that it would in many circumstances duplicate existing RSE licensee policies and processes and would not materially assist APRA's objective of improving expense management practices across the industry. Instead, SPS 515 requires that an RSE licensee ensure that its expenditure decisions are consistent with the best interests of beneficiaries.

In addition, APRA has removed the requirement that a business case be prepared for an item of significant expenditure, as was proposed under draft SPS 220. APRA's expectations around having a business case are more appropriately included as best practice expectations in SPG 515.

APRA has clarified the concept of 'significant expenditure' by defining it in SPS 515. The definition is supported by guidance in SPG 515 on APRA's expectations for how an RSE licensee would determine whether an expenditure is significant. The intent behind the definition is to ensure that instances of significant expenditure, regardless of the structure of an RSE licensee, are subject to rigorous decision-making and monitoring processes. For example, while the payments may in isolation be relatively small, an RSE licensee would be expected to consider whether multiple instances of related expenditure are significant in total.

2.3 Adequacy of resources

APRA proposed to harmonise the requirements relating to adequacy of resources between SPS 220 and the corresponding cross-industry standard, *Prudential Standard CPS 220 Risk*

Management (CPS 220). In doing so APRA proposed to replace existing *Prudential Practice Guide SPG 221 Adequacy of Resources* with draft SPG 221.

Comments received

APRA received minimal comments on its proposal to streamline the requirements for adequacy of resources, although a few industry stakeholders at the roundtables expressed the view that there was a benefit in retaining the existing SPG 221.

APRA's response

APRA considers resource management is a key function of the strategic and business planning process. Accordingly, APRA has streamlined the requirements in SPS 220 as proposed. Consistent with this decision, APRA will, on the commencement of the new requirements, withdraw SPG 221.

2.4 Management of reserves

APRA proposed to include guidance from *Prudential Practice Guide SPG 222 Management of Reserves* (SPG 222) in the proposed new guidance on business planning and expense management. This reflects APRA's view that the management and use of reserves is often central to an RSE licensee's fund expenditure decisions and meeting the cost of activities associated with the business plan.

Comments received

APRA received minimal comments on its proposal.

APRA's response

APRA has updated, and included guidance from draft SPG 222 in SPG 515. At the commencement of the new requirements APRA will withdraw SPG 222.

Chapter 3 – Outcomes assessment

This chapter sets out APRA's response to key matters raised in submissions in relation to the proposed outcomes assessment.

In draft SPS 225, APRA proposed that an RSE licensee undertake an annual assessment of the outcomes provided to members, and identify any areas for improvement across the RSE licensee's business operations. Specifically, APRA proposed that an RSE licensee:

- assess the outcomes provided to its members in both absolute terms and relative to objective benchmarks and other RSEs;
- consider the impact of its investments, insurance benefits, scale, product features and fund expenditure on the outcomes provided to members; and
- identify any changes to its operations that would improve outcomes provided to members.

Where such changes are identified, APRA proposed that RSE licensees consider the costs and benefits of making those changes as part of the annual review of their business plan.

Comments received

Industry stakeholders were generally supportive of APRA's intent in requiring RSE licensees to undertake a comprehensive assessment of the delivery of outcomes to members. APRA's proposals were seen to be consistent with the broad direction in which the industry is moving, with consultation indicating that many RSE licensees are already seeking to embed analysis of the delivery of outcomes into their strategic and business planning processes. However, industry stakeholders did raise some issues related to the location and design of the outcomes assessment proposed in draft SPS 225.

Industry stakeholders indicated a risk that the proposed outcomes assessment would be perceived to be a discrete point in time exercise, rather than an integral part of the business planning process. Industry stakeholders suggested that APRA should seek to align further the business planning requirements and the member outcomes assessment.

Regarding the design of the assessment, a concern raised by some stakeholders was the proposal to require comparison of the outcomes delivered to members to those outcomes delivered by other RSEs. Industry stakeholders argued that there are significant challenges in undertaking comparisons with the outcomes delivered by other RSEs. Industry stakeholders noted that the subjective nature of what constitutes quality outcomes for particular cohorts of members, and the differences between choice products, makes it extremely difficult to assess the outcomes delivered by other RSEs. Further, industry stakeholders also noted limitations on publicly available, timely data as a significant barrier in conducting a meaningful comparison of outcomes.

Views on the level of prescription within draft SPS 225 were mixed. Some industry stakeholders considered that subjective components of the assessment should be removed and the assessment be centred on financial metrics such as net investment returns. Additionally, some considered that APRA should set the methodology for conducting the assessment to ensure consistency across the industry and enable comparison. In contrast, others supported the RSE licensee having discretion in developing its approach to undertaking the assessment and considered the RSE licensee as best placed to understand and measure the delivery of outcomes to its membership.

Issues were raised by industry stakeholders in relation to how an RSE licensee should segment its membership for the purposes of assessing outcomes. Some industry stakeholders were concerned that RSE licensees could conceal substandard outcomes for some cohorts by defining cohorts of members in a broad manner. A number of industry stakeholders considered that APRA should specify how an RSE licensee should undertake segmentation, for instance by requiring, at a minimum, assessment at the product level.

A small number of industry stakeholders considered that defined benefit and legacy products should be excluded from the assessment as the cost and complexity of applying the assessment to these products would outweigh any benefits, and would divert RSE licensee attention away from closing legacy products. It was proposed that the exclusion of legacy products could be achieved through including a requirement that this was conditional on the RSE licensee providing APRA with a board approved plan for closing the respective product.

A number of industry stakeholders sought clarification from APRA on the overlap between APRA's proposed outcomes assessment, the existing MySuper scale test under section 29VN of the SIS Act and the proposed legislative replacement of the scale test with a broader outcomes test. Industry stakeholders considered that it was not clear in APRA's guidance, how the outcomes assessment under draft SPS 220 would interact with the MySuper scale test (or the proposed legislative replacement) and the extent to which an RSE licensee could rely on fulfilling the legislative test to meet its requirements under SPS 220.

APRA's response

Co-location with business planning requirements

As outlined in Chapter 2, APRA has aligned the requirements for an outcomes assessment with the business planning requirements. To meet these requirements, RSE licensees will need to consider the outcomes assessment as a key input into the business plan, setting of strategic objectives and assessing overall performance and progress in meeting the strategic objectives.

Design of outcomes assessment

APRA has considered industry stakeholders' concerns about the challenges in undertaking a meaningful comparison of their delivery of outcomes with those delivered to members of other RSEs. APRA has removed an explicit requirement that this be a component of the outcomes assessment, recognising that such a comparison may be difficult for many membership cohorts and may not yield meaningful results.

However, APRA has retained the proposed requirement for an RSE licensee to determine the metrics it utilises in the outcomes assessment by reference to objective benchmarks and targets. APRA expects these benchmarks will be both internal and external in nature and will provide important quantifiable inputs into the assessment. This approach strikes a balance between ensuring there are observable points of comparison that can be validated while avoiding the need for an RSE licensee to undertake a comparison that will not be meaningful to the assessment.

APRA expects that many RSE licensees will focus on net investment returns in assessing the delivery of outcomes, particularly for default (MySuper) members. However, a focus on net investment returns to the exclusion of other considerations would not be sufficient as it would not capture other key factors that impact member outcomes. Additionally, it would reduce the central role of the RSE licensee as having an obligation to understand and make decisions in the interests of their particular membership base. APRA is also concerned that a focus solely on net investment returns may have inadvertent consequences, for instance incentivising an RSE licensee to reduce costs in key risk and governance areas in an unsustainable manner in order to improve net investment returns. As a consequence, APRA has retained the proposed requirement that an RSE licensee take into account a broad range of factors when assessing the outcomes assessment metrics.

APRA has noted industry's concerns regarding RSE licensee discretion on segmenting membership. APRA recognises that discretion on segmentation may allow some RSE licensees to intentionally design the assessment in a manner that results in a favourable conclusion. However, in APRA's view, an RSE licensee is best placed to segment membership into meaningful cohorts. Accordingly, APRA is not providing additional prescription in SPS 515. Additional guidance on APRA's expectations in establishing cohorts is provided in SPG 515. In addition, a focus of APRA supervision of the outcomes assessment will be the rigour and analysis supporting RSE licensee decisions on establishing membership cohorts.

Application to defined benefit, legacy products and PSTs

APRA continues to expect that the outcomes assessment will be applied to all types of superannuation products, including defined benefit and legacy products. APRA has concerns with the delivery of outcomes to members in some legacy and defined benefit products and to exclude these products would undermine the objective of the prudential policy proposals.

APRA considered the proposal put by some industry stakeholders that legacy products could be excluded subject to a board approved transition plan provided to APRA. While APRA welcomes RSE licensees putting in place transition plans for all legacy products, it is not appropriate to exclude these products from the outcomes assessment. APRA has updated the guidance in SPG 516 to reflect that, in respect of legacy products, the citing of a board transition plan may in certain circumstances meet APRA's expectations with respect to the outcomes assessment for members of those products.

Pooled superannuation trusts (PSTs) have been excluded from the outcomes assessment requirements under SPS 515 in order to avoid duplication. Consideration of the performance of an RSE licensee's investment in a PST will, however, be captured under the respective RSE licensee's outcomes assessment.

Overlap with legislative requirements

APRA has provided guidance in SPG 516 on how an RSE licensee is able to reflect consideration of the MySuper scale test in completing the outcomes assessment in SPS 515. In effect, an RSE licensee can use the analysis performed for the scale test as a factor affecting its performance in relation to a MySuper product.

Specifically, an RSE licensee is required under the outcomes assessment to identify the factors that have affected performance as reflected in the calculation of the metrics. Where an RSE licensee undertakes the MySuper scale test, the findings of that assessment can be relied on to consider the extent to which scale has affected performance under the outcomes assessment. APRA will review whether any changes are needed to the prudential standards and guidance to maintain consistency with the Bill, if and when it is passed.

Chapter 4 – Other matters

This chapter sets out APRA's response to other matters raised in submissions, including the reporting collection.

4.1 Enhancements to the superannuation reporting framework

APRA has observed areas for improvement in respect of its collection and publication of comparable and detailed data, particularly relating to RSE-level and RSE licensee-level expenditure. Transparency in these areas is crucial to allow APRA, industry and the public to understand and analyse how fund assets are being used to support business operations, both within and across RSEs.

Amendments to the *Financial Sector (Collection of Data) Act 2001* (FSCODA) are currently before the Parliament and if enacted, will enable APRA to collect more comprehensive data relating to non-investment expenses incurred by RSEs and RSE licensees. The proposed reforms will do this by requiring the provision of information on a look-through basis in relation to transactions between an RSE licensee and another entity.

The discussion paper outlined the potential for APRA to make changes to:

- address inconsistency and enhance the quality of data currently provided by collecting more detailed and comparable data on fund expenses under *Reporting Standard SRS 330.0 Statement of Financial Performance* (SRS 330.0) and *Reporting Standard SRS 331.0 Services* (SRS 331.0), including the potential application of look-through on expenses resulting from amendments to FSCODA; and
- address gaps in RSE and RSE licensee level financial statement information through considering whether and how to collect financial statement information consistent with *Australian Accounting Standard 101 Presentation of Financial Statements*.

Comments received

Industry stakeholders raised broad reservations with the reporting proposals in the discussion paper, including the potential costs involved in complying with an expanded reporting collection framework. A significant focus of feedback in submissions and at the industry roundtables was on the proposal to apply look-through powers on expense reporting resulting from amendments to FSCODA, with the following broad issues raised:

- there will be significant compliance costs associated with reporting look-through data on expenses and the benefits from APRA collecting this information have not been established;
- obtaining accurate and comparable look-through data will be very challenging for many RSE licensees due to the use of bundled contracts covering the provision of a number of services by lead service providers and sub-contractors; and
- uncertainty about how look-through will apply in respect of arrangements with related party service providers and the number of service provider levels an RSE licensee will be required to look-through.

APRA's response

Updating the reporting collection, including in the areas outlined in the discussion paper, will support a transparent focus on the delivery of enhanced member outcomes. In addition, a number of other reviews and activities currently nearing completion will likely have implications for the superannuation data that is collected and published by APRA. This includes APRA's post-implementation review of the prudential framework and the Productivity Commission's final report on its review of superannuation.

In particular, the Productivity Commission in its draft report *Superannuation: Assessing Efficiency and Competitiveness* focused on the scope and quality of publicly available data on superannuation. A number of the draft recommendations and findings are relevant to APRA's reporting collection and areas for enhancement. Additionally, the proposed amendments to FSCODA are still before Parliament.

As a result, APRA is conducting further work to assess the scope and timeframes for amendments to the reporting proposals. APRA will conduct a separate consultation process on reporting proposals, most likely in 2019.

4.2 Simplifying mechanisms for opting out of insurance

The discussion paper proposed an amendment to *Prudential Standard SPS 250 Insurance in Superannuation* (SPS 250) to require an RSE licensee to provide a simple and straightforward opt-out process for all insurance products. This followed the Government suggesting that APRA address this issue in its announcement of a suite of superannuation reforms in July 2017.[2]

The discussion paper noted the work by industry in the development of the Insurance in Superannuation Voluntary Code of Practice. APRA indicated that it would consider whether any changes to *Prudential Practice Guide SPG 250 Insurance in Superannuation* (SPG 250) would assist industry's implementation of the proposed SPS 250 change following finalisation of the Code of Practice.

Comments received

Industry stakeholders were generally supportive of the proposal to make a minor amendment to SPS 250 on straightforward insurance opt-out processes. One submission did consider that APRA should wait until the Code of Practice was implemented by participating RSE licensees in order to assess if the change to SPS 250 is still warranted.

APRA's response

APRA has decided to defer changes to SPS 250 in respect of insurance opt-out processes until the final form of any related legislative changes arising out of the Government's Protecting Your Super package in the 2018-19 Budget are known, as these reforms will likely require further extensive changes to SPS 250.

[2] Minister for Revenue and Financial Services, Media release: Reforms to give consumers more power at the heart of a stronger superannuation system, 24 July 2017.

In addition, APRA will monitor opt-out processes and changes in insurance offerings following industry's adoption of the Code of Practice and assess whether industry developments should be reflected in any changes to SPS 250 and SPG 250.

4.3 Sole Purpose Test Circular

The discussion paper noted that APRA was assessing the appropriateness of current guidance on the sole purpose test in *Circular No. III.A.4 The Sole Purpose Test* (Circular No. III.A.4) and sought submissions on whether Circular No. III.A.4 remains relevant to industry.

Comments received

Industry feedback indicated that the APRA guidance on the sole purpose test is valued by the industry, but that the content of Circular No. III.A.4 requires significant updating. Additionally, industry recognised that the sole purpose test guidance would complement business planning expectations, as compliance with the sole purpose test is often considered by RSE licensees in the context of undertaking business initiatives and investments.

APRA's response

APRA considers that the sole purpose test is a threshold consideration for a prudent RSE licensee when setting strategic objectives, undertaking business planning and making decisions on associated fund expenditure.

In light of the value placed on the guidance, APRA will consider a review of the guidance as part of its work plan in early 2019.

4.4 Management information system

APRA proposed to align SPS 220 with the cross-industry risk management standard CPS 220 by requiring an RSE licensee to have a management information system (MIS) as a component of its risk management framework. APRA considered that it was appropriate to align with the other regulated industries in this area due to the increasing complexity and sophistication of many RSE licensees' business operations. Additionally, the proposed business planning and member outcomes assessment requirements necessitate an RSE licensee having in place effective systems to monitor performance.

Comments received

APRA received a small number of queries about the appropriateness of applying the MIS requirement to RSE licensees and uncertainty about the scope of the requirement.

APRA's response

An effective MIS is central to the management of risk and the monitoring of performance and outcomes, including business planning activity outcomes, across an entities' operations. APRA expects that for many RSE licensees the addition of the MIS requirement to SPS 220 will not require significant changes to existing systems and processes.

APRA has included guidance on MIS in SPG 515, which has been adapted from *Prudential Practice Guide CPG 220 Risk Management*, to assist RSE licensees in understanding APRA's expectations in relation to this requirement.

Chapter 5 – Implementation

Revised SPS 220 and new SPS 515 will commence on 1 January 2020. This means that an RSE licensee's first outcomes assessment will need to be conducted by 31 December 2020, though the timing of an RSE licensee's review of its business plan will determine when, in 2020, the first outcomes assessment will need to be undertaken.

In order for RSE licensees to comply with SPS 515 on 1 January 2020, during 2019 RSE licensees will need to identify and work towards addressing any deficiencies between existing practices and the new requirements in SPS 515. A guide to key milestones relating to the commencement of SPS 515, and APRA's supervisory approach to ensuring implementation over the next few years are set out in the diagram below.

Figure 2: Implementation timeline for RSE licensees

APRA encourages RSE licensees to commence work on the design of their outcomes assessment, and discuss the approach taken with APRA supervisors. The outcomes assessment represents a new prudential requirement and there will be a period of learning for the industry about how to construct the assessment, source relevant data and ensure the assessment is appropriately embedded in the business planning process.

APRA expects that the rigour of the assessment will improve as the industry develops experience in undertaking the assessment. In the first year APRA supervisors will look for reasonable efforts by RSE licensees to conduct the assessment in a comprehensive way and align it with their business planning processes. For some RSE licensees, segmentation in the first year may be at a relatively high level and may have a primary focus on MySuper members due to greater availability of MySuper data. However at least some preliminary assessment of outcomes for all products and members is expected. As RSE licensees develop a more sophisticated approach to identifying cohorts of members, using internal and external metrics and assessing outcomes, a more comprehensive and robust approach will evolve.

APRA will also review its guidance as industry implements the new requirements and as practices across the industry evolve.

Attachment A – Summary of final requirements

This Attachment provides a summary of the final requirements relating to SPS 220, SPS 515, SPG 515, SPG 516 and Circular No.III.A.4, and consequential amendments to other standards and practice guides.

Revised Prudential Standard SPS 220 Risk Management	
Former paragraph 16(c)	Requirement to have a business plan moved to new SPS 515.
Paragraph 16(f)	New paragraph replicated from CPS 220.
Former section “Strategic and business planning”	Requirement to have a business plan relocated to SPS 515. Remaining requirement (in new SPS 515) aligned with CPS 220.
Paragraph 20(a)	Amended to align with CPS 220.
Paragraph 29(b)	Amended to include the words “whether these activities are supported by adequate resources”.
Former section “Adequacy of resources”	Deleted.

Prudential Standard SPS 515 Strategic Planning and Member Outcomes (NEW)	
Entire Prudential Standard	New.

Prudential Practice Guide SPG 515 - Strategic and Business Planning (NEW)	
Entire PPG	New but includes former guidance relating to adequacy of resources in SPG 221 and management of reserves in SPG 222.

Prudential Standard SPG 516 - Outcomes Assessment (NEW)	
Entire Prudential Standard	New.

Prudential Practice Guide SPG 220 - Risk Management (EXISTING)	
Paragraphs 19 to 21 inclusive	Consequential amendments to be made in due course to reflect relocation of the requirement to have a business plan to SPG 515.

Prudential Practice Guide SPG 221 - Adequacy of Resources (EXISTING)	
Entire SPG	To be withdrawn on 1 January 2020.

Prudential Practice Guide SPG 222 - Management of reserves (EXISTING)	
Entire SPG	To be withdrawn on 1 January 2020.

Circular No.III.A.4 The Sole Purpose Test (EXISTING)	
Entire Circular	APRA's work plan for 2019 to consider review of Circular.

Attachment B – Regulatory costs

This Attachment sets out the costs associated with the options explored by APRA to strengthen outcomes for superannuation members and drive improvements in strategic and business planning and fund expenditure management.

In August 2017, APRA initially outlined its proposals in conceptual form in a letter to RSE licensees. In December 2017, APRA released for public consultation a discussion paper which outlined three options for strengthening superannuation member outcomes and to drive improvements in strategic and business planning and fund expenditure management. Those three options were:

Options	Approach
Option 1: Status quo	No changes would be made to APRA's existing prudential requirements on strategic and business planning in *Prudential Standard SPS 220 Risk Management* (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. *Prudential Practice Guide SPG 220 Risk Management*) 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.

APRA's public consultation was open for fifteen weeks. Fifteen public and two confidential submissions were received, in addition to six public submissions in response to APRA's initial consultation letter. APRA also conducted industry roundtables and informal consultation to further discuss the proposals.

Assessment of regulatory costs

As part of its public consultation, APRA sought information from stakeholders on the compliance impacts of the proposed changes set out in the discussion paper, including associated substantive costs. 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.[3]

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

[3] The Commonwealth Regulatory Burden Measure is available here: https://rbm.obpr.gov.au/home.aspx

(Option 3). APRA has not used this entity's estimate of costs as it is a highly complex entity with a number of legacy systems. APRA considers it is not appropriate to apply this entity's estimate of costs across the industry as it is unlikely to be an accurate measure of the likely costs for implementing the proposed changes.

A further consideration in assessing regulatory costs is that APRA has made significant changes to its 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 these changes is a significant reduction in the likely total compliance costs under Option 3.

APRA considers that the additional costs to be incurred chiefly arise from the member outcomes assessment as these requirements are new. Any additional material costs incurred by RSE licensees under Option 3 are likely to be in the expenditure requirements, which will require more rigour in decision making and monitoring of items of significant expenditure. 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 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.

APRA has assumed that the primary cost will be incurred in the first year when the member outcomes assessment is developed, with a lower cost incurred in future years. Measuring member outcomes should be a relatively low cost process once the design is embedded, following implementation. In future years, the design of a member outcomes assessment may need some changes, prompted by evolution in RSE licensee practices and any future updates by APRA to guidance, however these additional costs are expected to be lower than the initial implementation.

APRA has therefore assumed that the highest cost will be incurred in the first year, with costs reducing after that and remaining stable for the next nine years.

All costs represented in the Tables in this section reflect the amortised cost per year over a 10-year time horizon.

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):

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 standards 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

Conclusion

Under Option 1, there would be no additional compliance costs. Under Option 2, the additional costs are estimated to be in the range of $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. 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. 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.

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

Implementation and review

The requirements will commence on 1 January 2020, which will provide industry with 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 likely changes of this nature since APRA's August 2017 letter.

As delegated legislation, prudential standards impose enforceable obligations on affected RSE licensees. APRA monitors ongoing compliance with its prudential framework as part of its supervisory activities and 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 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.

Glossary

APRA	Australian Prudential Regulation Authority
AASB	Australian Accounting Standards Board
The Bill	Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017
draft SPG 221	Proposed new *Prudential Practice Guide SPG 221 Outcomes for beneficiaries*
draft SPG 222	*Prudential Practice Guide SPG 222 – Management of Reserves*
draft SPG 225	Proposed new *Prudential Practice Guide SPG 225 Outcomes assessment*
draft SPS 225	Proposed new *Prudential Standard SPS 225 Outcomes Assessment*
FSCODA	Financial Sector (Collection of Data) Act 2001
Look-through	For the purposes of this discussion paper, look-through refers to the RSE licensee or RSE identifying the ultimate expense category and expense value paid to a third party or non-connected entity.
New SPS 515	New *Prudential Standard SPS 515 Strategic Planning and Member Outcomes* (SPS 515)
New SPG 515	New *Prudential Practice Guide SPG 515 Outcomes assessment*
New SPG 516	New *Prudential Practice Guide SPG 516 Outcomes Assessment*
Prudential framework	Prudential framework refers to the legislation, prudential standards and prudential guidance for each respective industry that is applicable to a regulated institution.
Prudential requirements	In the context of this paper, the term 'prudential requirements' refers to the requirements in the prudential framework and applicable reporting requirements under the *Financial Sector (Collection of Data) Act 2001*.
Revised SPS 220	Revised *Prudential Standard SPS 220 Risk Management*
RSE	Registrable superannuation entity
RSE licensee	Registrable superannuation entity licensee

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