Actuaries Institute.

19 December 2023

General Manager, Policy
Policy and Advice Division
Australian Prudential Regulation Authority

Dear Sir/Madam,

Consultation: Draft Enhancements to Strategic Planning and Member Outcomes Framework

The Actuaries Institute (Institute) welcomes the opportunity to provide feedback on APRA's consultation to enhance its strategic planning and member outcomes regulatory framework, collectively updated drafts of:

- Prudential Standard SPS 515 Strategic Planning and Member Outcomes (SPS 515).
- Prudential Practice Guide SPG 515 Strategic and Transfer Planning (SPG 515).
- Prudential Practice Guide SPG 516 Business Performance Review (SPG 516).

The Institute is the peak professional body for actuaries in Australia. Our members have had significant involvement in the development and management of superannuation in Australia, and work across APRA regulated funds, SMSFs and public sector funds.

The Institute supports APRA's initiative to uplift SPS 515 and associated guidance, given its critical role in supporting better superannuation member outcomes. We congratulate and support APRA on the increased clarity from integrating SPS 515 requirements with associated guidance in SPG 515 and SPG 516, and the designation of SPS 515 as a core prudential standard in the business operations pillar in APRA's prudential framework. We welcome the following proposed changes to SPS 515:

- Inclusion of updated legislative requirements since SPS 515 was introduced, such as consideration of retirement income strategy and annual performance test outcomes when developing strategic objectives.
- An expectation that financial projections are to be developed under a range of alternative scenarios and assumptions on both a historical and forward-looking basis to inform business planning.
- More principles-based regulation applying to transfer planning especially the adoption of a trigger framework for when a formal plan is required.

Actuaries Institute
Level 2, 50 Carrington Street, Sydney NSW 2000
P +61 (0) 2 9239 6100 | actuaries.asn.au
ABN 69 000 423 656

- The Trustee Board not being required to assess the methodology for financial projections used in a business plan as this is better left to those with appropriate professional expertise (internal or external), and instead the expectation is that the Board has a sound understanding of the methodology.

We set out in the Attachment to this submission our specific recommendations to enhancements proposed by APRA. In summary:

- There is tension for trustees in fulfilling SPS 515 requirements which encourage a more holistic approach to promoting financial and non-financial member outcomes, with the Best Financial Interest Duty (BFID) which is only focused on the financial outcomes. There is an opportunity to provide further clarity.
- When articulating member outcomes, it is important to go beyond product outcomes and consider the sum of a member's interests in a fund to measure actual "member outcomes". For example, "member outcomes" could be aligned with trustee obligations under the Retirement Income Covenant.
- We expect many trustees will need to uplift the financial projections of their business, including the level of future reserves. Actuaries have been assisting trustees manage future financial positions of defined benefit funds for many years and have increasingly applied similar projection techniques to help trustees better manage future uncertainties in the operation of superannuation funds. For example, to help trustees understand the impact of potential changes to fund membership, strategic initiatives, financial conditions and external events on the fund's future financial position and reserve levels. We recommend APRA consider the role and involvement of professional expertise in its guidance to trustees in areas like this that require greater rigour and expert input, particularly financial projections and the management of reserves.
- We recommend APRA consider clarifying its expectation around the period for review of a trustee's retirement income strategy with the integration into the annual business planning cycle. In our view, trustees should be required to perform a comprehensive review of their retirement income strategy at least every three years, but not necessarily annually.
- To support more effective and timely business planning, we recommend APRA consider where it could bring forward its timeframe to publish annual statistics, to say end of September. This would allow many trustees to complete annual outcomes assessments by the end of Calendar Year and for business planning to be sequenced thereafter.
- While it is appropriate for SPS 515 to recognise the impact of the annual performance test when assessing MySuper and trustee directed products, requiring trustees to use the performance test benchmark for product comparisons is inappropriate. Further, APRA could provide additional clarity on "appropriate peer groups" for product comparisons.
- We support APRA's expectation for trustees to regularly review the appropriateness of retirement income products with unique features against other comparable products but highlight the difficulty of sourcing suitable data for comparison unless it is collected and provided by APRA.

- When assessing scale impacts, more consideration should be given to “borrowed” scale through external investment managers or service providers and strategic scale benefits.

The Institute would be pleased to discuss this submission.

Yours sincerely

Attachment: Detailed recommendations

SPS 515 and SPG 515

Non-financial member outcomes and the Best Financial Interest Duty (BFID)

Although APRA's expectations relate to different legal and regulatory requirements, we note BFID is focused on financial outcomes only whereas APRA would expect, and we agree, that trustees take a holistic focus when articulating member outcomes. For example, there is a benefit to members from building members' confidence in planning for their retirement and giving members peace of mind.

The proposed uplift to SPS 515 in part supports a holistic focus in the context of member outcomes. SPS 515 paragraph 9 a) would require that the strategic objectives of the trustee must be informed by the trustee's consideration of *"the specific outcomes that the RSE licensee seeks to achieve for beneficiaries"*. SPG 515 paragraph 7 articulates further that: *"APRA expects an RSE licensee's articulated member outcomes incorporate **both financial and non-financial outcomes**"* (bolded for emphasis).

However, this is then potentially contradicted in the context of fund expenditure decisions. SPS 515 paragraph 22 b) states: *"When making expenditure decisions relating to its business operations, an RSE licensee must demonstrate, at a minimum: where the expenditure results in a non-financial benefit to beneficiaries, or a benefit not directed towards promoting the financial interests of beneficiaries, why, in such circumstances, the expenditure remains consistent with all legal duties and obligations of the RSE licensee'"*. Draft SPG 515 paragraph 35 expands further that *"Rigorous decision-making in relation to fund expenditure positions an RSE licensee to meet the duty to act in the best financial interests of beneficiaries and is likely to lead to more considered use of fund monies and better quality outcomes for members..."*.

To support trustees to take a holistic focus, we recommend APRA consider providing additional guidance around how trustees should interpret non-financial benefits and outcomes to members in the context of expenditure management.

Articulating member outcomes

SPG 515 Figure 1 provides a range of illustrative examples of the types of outcomes trustees might seek for their members. We believe these examples encourage outcomes to be articulated from a financial product perspective rather than member outcomes from a retirement income perspective. We recommend APRA consider including additional guidance in line with the objectives of the retirement income covenant, that is **to maximise the projected retirement income a member receives, taking account of the accessibility and risk objectives included within the Retirement Income Covenant.**

Member outcomes should not only focus on peer relative outcomes but also **consider the sum of a member's interests in a fund**. Taking an individual member or cohort level view might mean, for example, that a trustee considers outcomes of:

- Projected retirement balances given current contribution levels and investment strategies;
- Projected retirement income, taking account of the accessibility and risk objectives included within the Retirement Income Covenant;
- Administration fees relative to costs for that type of member; and
- Value of insured benefits in the event of an insurance claim.

At the same time, an analysis of individual member behaviour may indicate that some members are experiencing worse outcomes than anticipated. This could include the impact of:

- Switching to cash during market volatility and remaining there for a long time until retirement;
- Materially lower net return for the period, for example compared to a default member or after allowing for proxies; and/or
- Selecting into a retirement solution that is clearly detrimental to their retirement outcomes.

This would help with incorporating cohort construction into annual outcome assessments beyond simply a product focus.

Role of professional expertise

We expect many trustees will need to uplift the financial projections of their business, including the level of future reserves. Actuaries have been assisting trustees manage future financial positions of defined benefit funds for many years and have increasingly applied similar projection techniques to help trustees better manage future uncertainties in the operation of superannuation funds. For example, to help trustees understand the impact of potential changes to fund membership, strategic initiatives, financial conditions and external events on the fund's future financial position and reserve levels.

Considering these areas in more detail:

- Financial Projections
  - Trustees will be required to complete financial projections under different potential scenarios for at least the term of the business plan (assumptions and how risks are taken into account must also be specified). We expect whole of fund projections based on best estimate demographic and financial assumptions should be prepared (stress testing of demographic and financial scenarios should also be completed).

- Management of Reserves
  - Trustees' strategies to manage reserves would ideally be based on a whole of fund model and involve scenario testing to inform the appropriate target amounts or ranges for reserves, establishment plans and restoration plans.
  - Reserves should be stress tested. As an example, for an administration fee reserve, this should be done in conjunction with the setting of fees to show that fees are sustainable and robust to stress scenarios.
  - There are some reserves where expert input is required given their specialist nature. For example, the management of insurance reserves likely requires actuarial input.

We recommend APRA consider the role and involvement of professional expertise in its guidance to trustees in areas that require greater rigour and expert input.

Review of the retirement income strategy

SPS 515 paragraph 12 would require that an RSE Licensee's business plan *"be informed by an annual review of the appropriateness of the RSE Licensee's retirement income strategy."*

We also note that in SPG 516 Paragraph 15, APRA would expect an RSE Licensee *"in its business performance review, demonstrate how its retirement income strategy has delivered appropriate outcomes for beneficiaries…".*

We query whether the SPS 515 paragraph 12 requirement is necessary, as this would appear additional to considering outcomes of the retirement income strategy in an RSE's Licensee's annual business performance review (which then informs the business plan).

We believe it would be more appropriate to require a comprehensive review of a RSE Licensee's retirement income strategy to occur on a triennial basis, building on SPG 515 paragraph 19 which states that *"a prudent RSE Licensee would also consider the benefits of obtaining an independent review of its retirement income strategy at least every three years by an operationally independent and appropriately experienced person.*

SPG 516

Timing and sequencing of the assessment

SPG 516 paragraph 31 states *"APRA expects an RSE licensee would generally endeavour to undertake the annual outcomes assessments for each MySuper and choice product **within two months of the publication** of APRA's most recent heatmaps, informed by other relevant publications issued by APRA."*

Since the start of this consultation, APRA has, in its recent Insights Paper on the 2023 Performance Test, for 2024 committed to align the timing of the heatmap publications with the performance test results which APRA is required to publish by the end of August. We welcome this initiative as we consider this will help trustees to embed an effectively sequenced outcomes assessment, business performance review and business planning process. **We recommend APRA commit to publishing heatmaps at the same time of the performance test from 2025 onwards to align with the commencement of the enhanced SPS 515 requirements.**

Other relevant publications issued by APRA include the annual statistical publications (Annual MySuper statistics and Annual Fund-Level Superannuation statistics). These publications continue to be scheduled for release in December. From a practical sequencing perspective, this would be too late as we envisage that trustees would likely complete their annual outcomes assessments and be sufficiently progressed through their business performance review before these annual statistical publications would be available.

By the time the business plan is prepared following the annual outcome assessment, the annual statistical publications for industry comparison would be almost one year out of date. It then posts another challenge for RSE licensees to develop their strategic plan with out of date data and risks more RSE licensees treating it as a tick box compliance exercise.

We recommend APRA to consider releasing their annual statistical publications earlier (for example end of September).

We note APRA's preferred timing and sequencing of assessments following APRA's publication schedule does not necessarily align with the business planning cycle of all RSE Licensees, some of which use a calendar year approach for their planning cycle. APRA should formally recognise that there are instances where alternative timing and sequencing of assessments may be appropriate.

Performance comparison metric

SPG 516 paragraph 36 provides an example of a comparison metric with *"the comparison results in a MySuper product placing in respect of the **performance test benchmark** calculated with respect to fees and costs and net return"* (bolded for emphasis).

The legislated performance test was designed as a threshold test (pass or fail), and it measures how an investment portfolio is performing relative to a benchmark constructed from prescribed indices and the product's strategic asset allocation on a net of tax and investment management fees basis. Therefore, the **performance test benchmark is inappropriate to be used as a metric for product comparison** (such as product ranking) purposes.

For the purposes of comparing MySuper or choice products, SPS 515 paragraph 27 b) would require that a RSE licensee demonstrate how it has considered the population of products against which it was assessed if applicable. SPG 516 paragraph 42 expands on this requirement, and states *"APRA expects an RSE licensee's outcomes assessment for a choice product would be informed by benchmarking, including APRA's heatmaps and other relevant publications, and* ***comparison with appropriate peer groups****"* (bolded for emphasis).

We believe APRA should provide additional clarity on what is considered "appropriate peer groups". For example, grouping choice products with investment options at similar level of investment risks by considering "risk band", or consideration of products offered on a platform which are designed to cater for typically higher member balances, level of member engagement often aided by a financial adviser and where the investment might be managed by an external fund manager.

While it is great to see integration of regulations, we recommend the ATO YourSuper comparison tool as the consumer facing tool that implements the performance test outcomes should also be aligned by including the appropriate peer groups suggested SPG 516 paragraph 42 once the tool is extended to Choice products. The Institute continues to have concerns that the YourSuper comparison tool, in its current format, does not achieve its intended objective and is leading to sub-optimal outcomes for members (refer to our previous correspondence).

Comparing retirement income products

SPG 516 paragraph 45 states: *"For products with unique features, APRA expects the RSE licensee to* ***regularly review the appropriateness*** *of these features for its membership,* ***analyse take-up rates and compare these to other comparable products****"*. (bolded for emphasis)

We support APRA's expectation on trustees to regularly review the appropriateness of unique product features. However, we highlight that by their very nature, the unique features of these products may mean it is difficult for trustees to locate comparable products.

We believe any comparisons should involve at least the three objectives under the retirement income covenant: level of retirement income, associated risk to the sustainability and stability of the retirement income; and flexible access to the retirement savings.

Given the long-term nature of retirement income products and where the final member outcome cannot be known with certainty until the member passes away, we would expect trustees taking a sophisticated approach (including scenario analysis in addition to the projections forward on an expected outcome basis) to compare products, and outcomes for members within these products, on a forward-looking basis against the objectives under the retirement income covenant.

We also highlight the **practical challenge of sourcing any comparison statistics especially take-up rates unless it is going to be collected and provided by APRA**. There will be a range of retirement related statistics that trustees would benefit from understanding such as account-based pension FUM, membership, demographics, drawdown rates and any innovative income streams take-up rates. It would be best for this information to be collected and provided by APRA. We look forward to forthcoming consultations on this topic as part of Phase 2 of APRA's Superannuation Data Transformation project.

Actuaries Institute.

Considerations when assessing scale impacts

SPG 516 Attachment A proposes considerations for trustees when assessing scale impacts. We suggest this list be updated to recognise "borrowed" scale through external investment managers or service providers and on strategic scale benefits.