



APRA

# insight

ISSUE ONE | 2015

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Superannuation industry overview

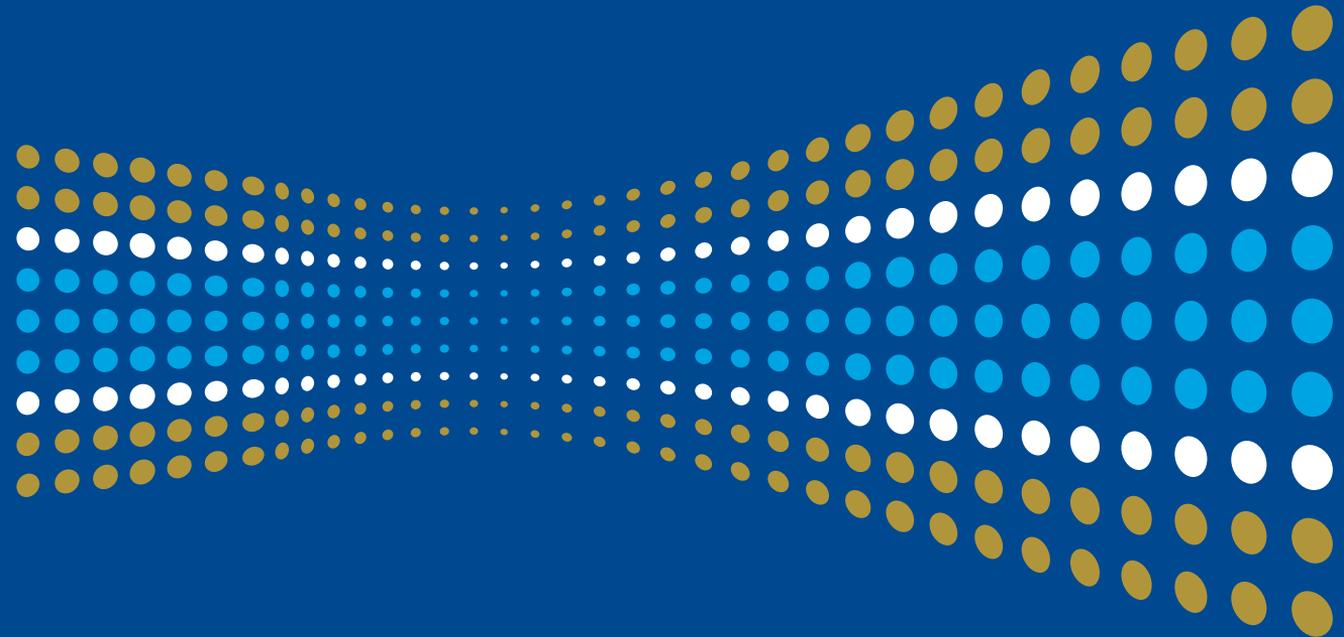
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Conflicts of interest thematic review

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Insurance in superannuation thematic review

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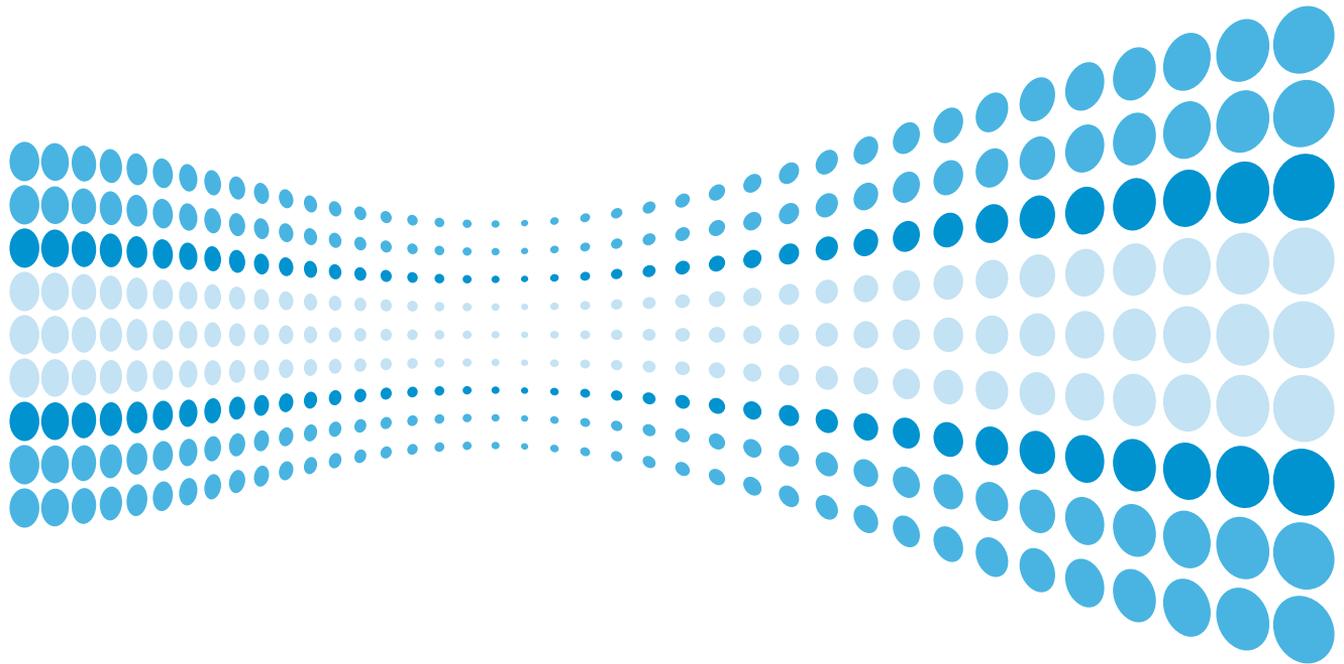




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ISSUE ONE | 2015



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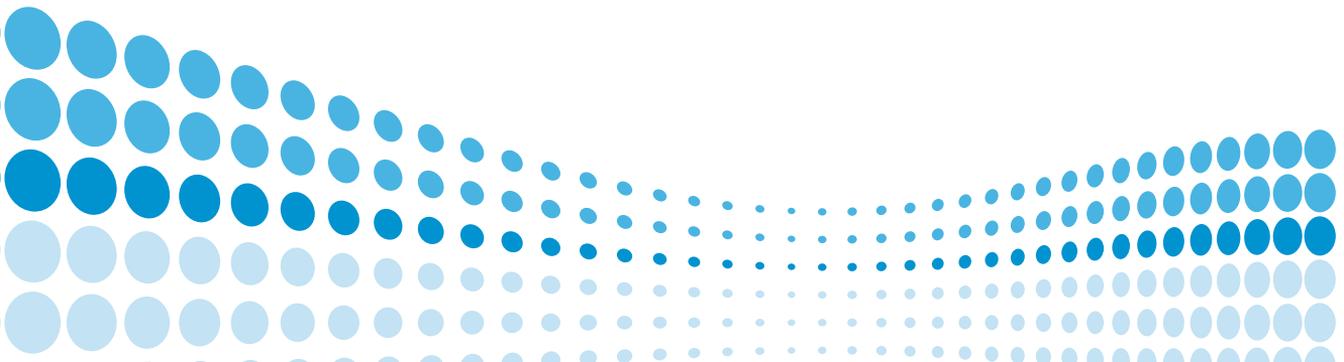
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**1****SUPERANNUATION INDUSTRY OVERVIEW**

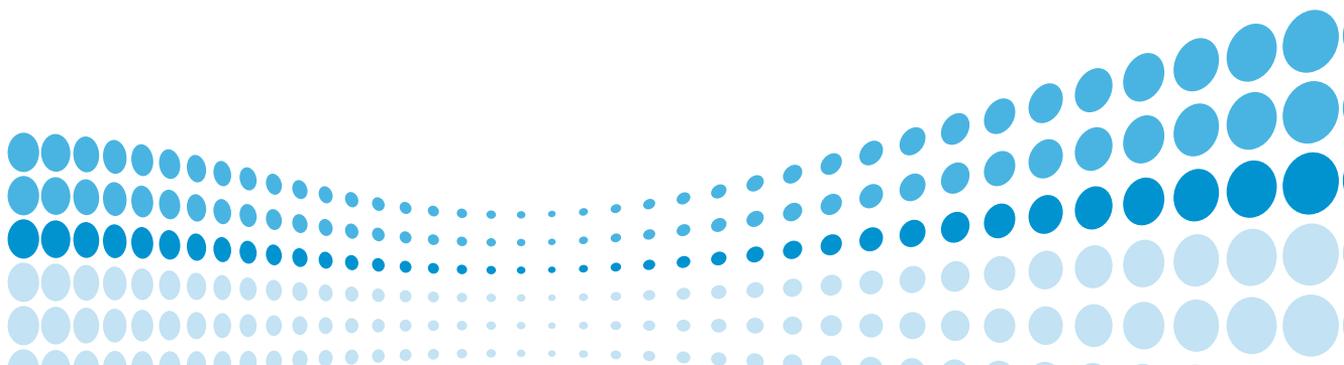
This article provides an update on the financial position and performance of the superannuation industry over the 2014 calendar year, with particular focus on the APRA-regulated sector.

**26****CONFLICTS OF INTEREST THEMATIC REVIEW**

This article provides an overview of the key findings and considerations of APRA's thematic review into the superannuation industry's implementation of *Prudential Standard SPS 521 Conflicts of Interest*.

**36****INSURANCE IN SUPERANNUATION  
THEMATIC REVIEW**

This article provides an overview of the key findings and considerations of APRA's thematic review into the superannuation industry's implementation of *Prudential Standard SPS 250 Insurance in Superannuation*.



# SUPERANNUATION INDUSTRY OVERVIEW

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This article provides an update on the financial position and  
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performance of the superannuation industry over the 2014 calendar  
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year<sup>1</sup>, with particular focus on the APRA-regulated sector. It discusses  
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APRA's views on, and expectations for managing key risks and issues  
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facing trustees that hold Registrable Superannuation Entity (RSE)  
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licences, as they continue to embed the recent reforms.  
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1 This article includes data for the 2013/14 financial year, and, where available, more recent data to 31 December 2014, based on quarterly D2A returns submitted to APRA. All statistical data has a month-end effective date, unless stated otherwise.

**SUPERANNUATION INDUSTRY OVERVIEW**

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**Introduction**

Superannuation industry assets grew strongly in 2014, buoyed by good investment performance. Net contributions remained relatively steady; however, benefit payments increased as more superannuation members transition into retirement. The long-term trend of superannuation industry consolidation gained pace over the year, while migration of large balances from the APRA-regulated sector to self-managed superannuation funds (SMSFs) continued to slow.

A significant focus for the industry over the year was the implementation and embedding of the new prudential standard requirements that came into effect from 1 July 2013. RSE licensees continued to strengthen their frameworks and policies across the areas covered by the standards, however further work is needed in many areas to meet the enhanced expectations set out in the prudential standards. Other areas of focus were implementation of the enhanced reporting requirements that support the Stronger Super reforms, and also implementation of the SuperStream contribution processing requirements.

APRA's efforts over 2014 were directed towards review and oversight of the implementation efforts being undertaken by the industry, with particular focus on a few key areas. Notably, APRA has stepped up its engagement with boards, and stressed the importance of strong governance, robust conflicts management and enhanced risk management. The need for more sustainable insurance arrangements, including enhanced insurance management frameworks and more robust data management practices have also been emphasised.

## SUPERANNUATION INDUSTRY OVERVIEW

### Overview of the superannuation industry

#### Superannuation assets

Over the 2013/14 financial year, the value of total superannuation industry assets increased by 13 per cent to \$1.8 trillion, equivalent to 116 per cent of Australia's Gross Domestic Product (GDP) (Figure 1). Total assets increased by a further 5 per cent to \$1.9 trillion in the second half of the calendar 2014 year. The APRA-regulated sector made up \$1.2 trillion (61 per cent) of total assets, as at December 2014.

Investment performance was the key driver of growth over 2014, with net contributions flows<sup>2</sup> remaining relatively stable. Continued strength

in global and domestic equity markets, although faltering in the second half of 2014, contributed to another year of positive investment returns.

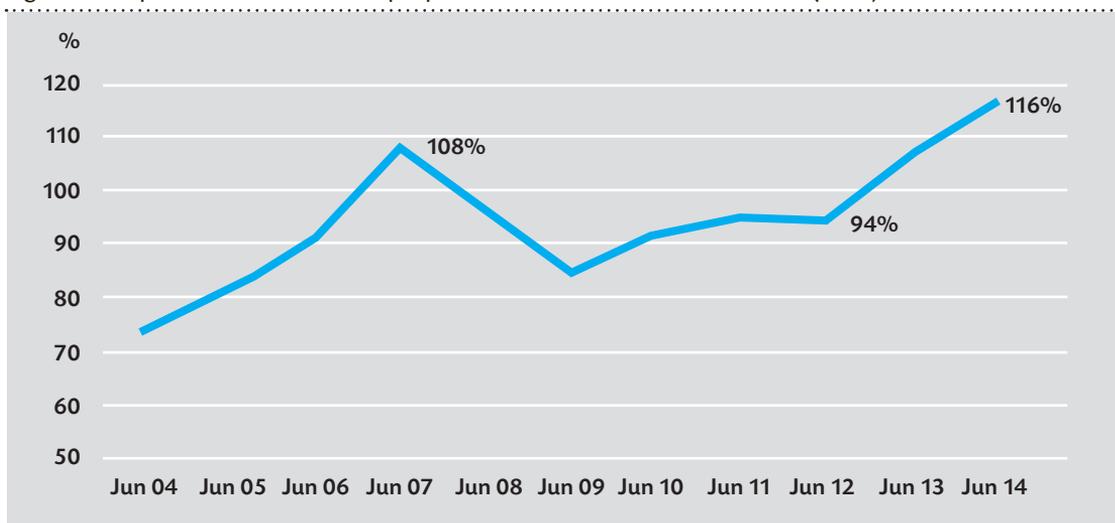
#### Industry structure

##### Number of RSE licensees and RSEs

The rate of industry consolidation increased significantly in 2014<sup>3</sup>. The number of RSE licensees reduced by 24, to 169, over 2013/14 before declining by a further four, to 165, as at December 2014 (Figure 2).

The number of RSEs declined by 29, to 278<sup>4</sup>, over 2013/14 (Figure 3), and contracted by a further 19, to 259, by December 2014.

Figure 1 - Superannuation assets as proportion of Gross Domestic Product (GDP)



Source: ABS & APRA Statistics

<sup>2</sup> Net contribution flows equal total contributions plus net rollovers less benefit payments and are gross of contributions tax and surcharge.

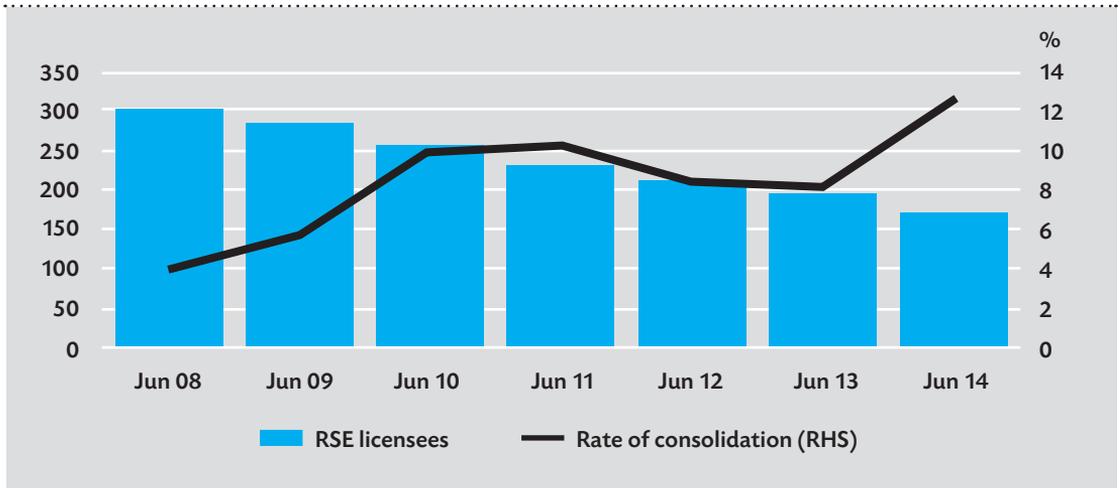
<sup>3</sup> Rate of consolidation measures percentage annual decline in the number of RSE licensees.

<sup>4</sup> In this article, RSEs include entities with more than four members and exempt public sector superannuation schemes (EPSSSs). APRA-regulated RSEs referenced in this article exclude EPSSSs.

## INSIGHT ISSUE ONE 2015

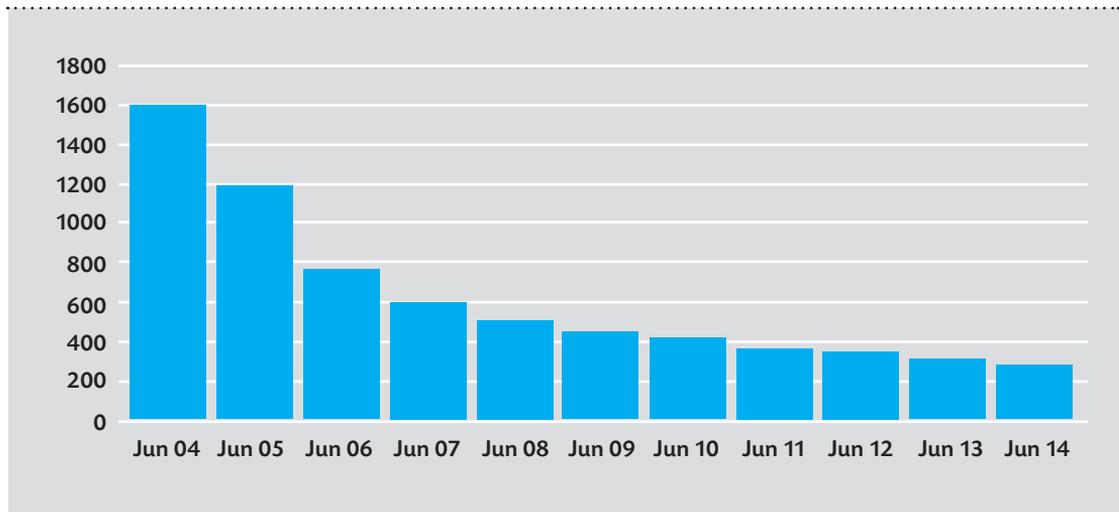
## SUPERANNUATION INDUSTRY OVERVIEW

Figure 2 - Number of RSE licensees



Source: APRA Statistics

Figure 3 - Number of RSEs



Source: APRA Statistics

## INSIGHT ISSUE ONE 2015

## SUPERANNUATION INDUSTRY OVERVIEW

As at June 2014, the top 20 APRA regulated RSEs accounted for 64 per cent of total assets and 58 per cent of member accounts (Figure 4).

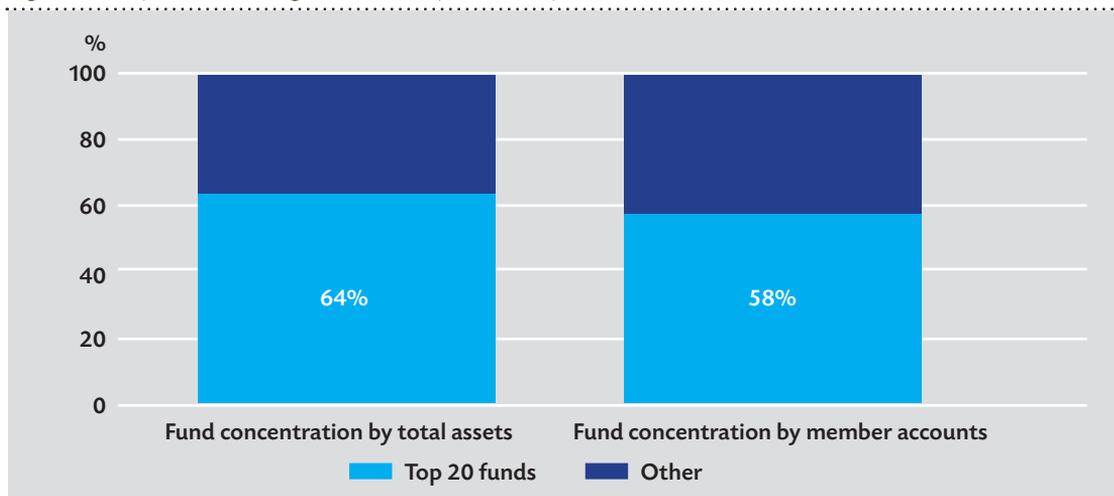
Despite continued consolidation, the superannuation industry in Australia is considered to be much less concentrated compared to other APRA-regulated industries. As at December 2014, the four major banks held 78 per cent<sup>5</sup> of total industry assets. In the general insurance sector, the four largest insurance groups accounted for approximately 75 per cent<sup>6</sup> of the direct personal and commercial lines markets, based on gross earned premium in 2014. The four largest life insurers held 80 per cent<sup>7</sup> of total assets as at June 2014. In the superannuation industry, the four largest RSEs held 20 per cent of all industry assets as at June 2014 (Figure 5). The median APRA-regulated RSE had total assets of \$0.7 billion and 10,216 member accounts.

### Number of member accounts

Total superannuation member accounts fell marginally to 31 million over 2013/14. This follows a slightly more rapid contraction in the prior year (Figure 6), due to lost and inactive accounts below \$2,000 having been closed and balances transferred to the Australian Taxation Office (ATO) in 2013.

The Financial System Inquiry (FSI) observed that a relatively high number of members with multiple accounts remains a feature of the Australian superannuation system and contributes to inefficiencies and higher overall costs for members. The trend of account consolidation is likely to continue and is expected to have implications for the level and structure of administration fees.

Figure 4 - Top 20 APRA-regulated RSEs (June 2014)



Source: APRA Statistics

<sup>5</sup> APRA Quarterly Authorised Deposit-taking Institution Performance Statistics, 31 December 2014.

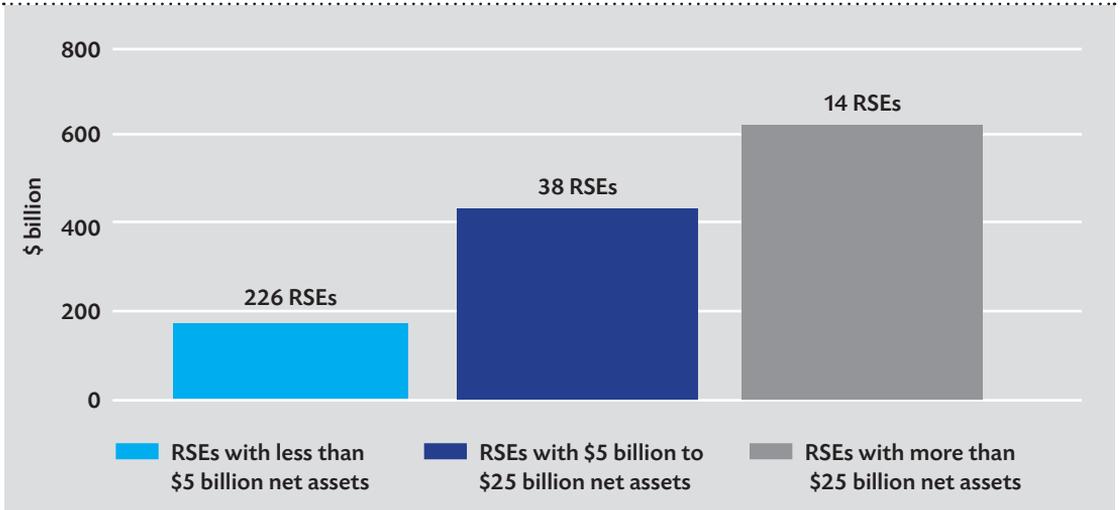
<sup>6</sup> These estimates are based on gross earned premium data collected by APRA for the 12 months to 31 December 2014.

<sup>7</sup> APRA Life Insurance Institution-level Statistics, 30 June 2014.

## INSIGHT ISSUE ONE 2015

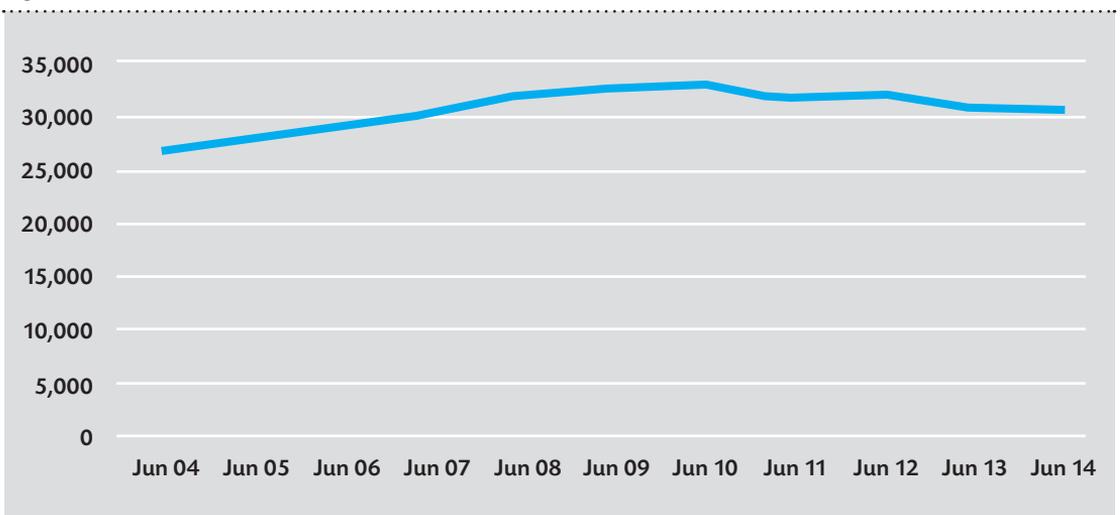
## SUPERANNUATION INDUSTRY OVERVIEW

Figure 5 - RSE total assets (June 2014)



Source: APRA Statistics

Figure 6 - Superannuation member accounts



Source: APRA Statistics

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**SUPERANNUATION INDUSTRY OVERVIEW**

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**Structure of retirement benefits**

There continued to be a slow but steady contraction in the proportion of defined benefits, with defined benefit members' benefits falling to 23 per cent of the total liability for members' benefits of RSEs as at December 2014, from 25 per cent at December 2013. This trend is expected to continue in future as most defined benefit funds or sub-funds are closed and their liabilities will run-off over time.

The majority of the defined benefit funds and sub-funds have experienced healthy funding levels in recent years, mainly due to the strong performance of equity markets. However, the financial position of these funds needs to be monitored on an ongoing basis by RSE licensees, given the impact that adverse experience, such as the potential effects of a prolonged period of low interest rates or material declines in asset values, may have.

**Industry asset allocation**

The investment portfolios of RSE licensees continued to be dominated by equities. As at December 2014, 51 per cent of the \$1.2 trillion in assets of RSEs were invested in equities, comprising 24 per cent in Australian listed equities, 22 per cent in international listed equities and 5 per cent in unlisted equities. A further 19 per cent of assets of RSEs were invested in fixed income, 14 per cent in cash and 12 per cent in property and infrastructure. The balance of 4 per cent was invested in other assets, including hedge funds, and commodities (Figure 7).

The level of unlisted assets, which can be more illiquid, stood at 13 per cent of the total as at December 2014. These assets included unlisted equity, property and infrastructure (Figure 8).

As at December 2014, approximately 30 per cent of investments of RSEs were invested in international listed equities, international fixed income and international unlisted infrastructure, with varying levels of hedging. There continues to be evidence of growing demand for offshore investments, particularly among larger funds, as RSE licensees seek greater diversification in sources of risk and return. Navigating these markets, either directly or through a manager, introduces additional risks, including political, currency and liquidity risks, and taxation consequences. APRA expects RSE licensees to have in place strong investment governance and robust risk management frameworks to effectively identify and manage these risks.

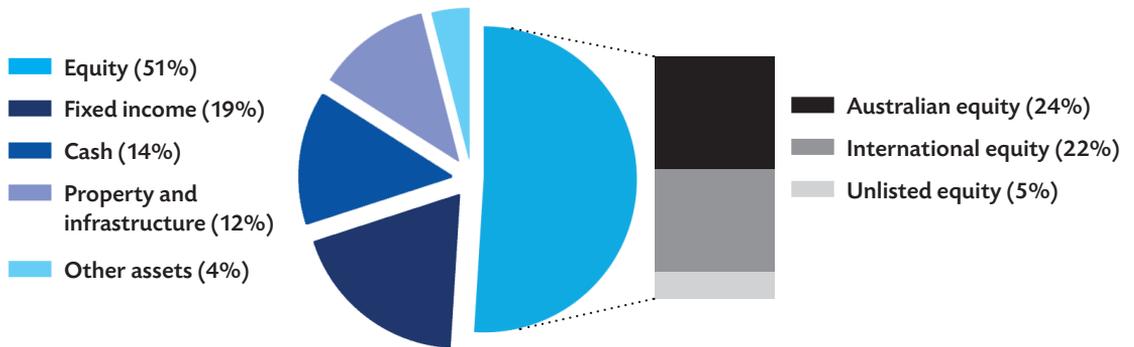
Currency is a significant driver of returns on overseas assets and is also an additional source of risk for RSEs. The recent decline in the value of the Australian Dollar and increasing volatility in foreign exchange markets has highlighted the importance of continually monitoring and managing foreign currency exposures. APRA expects RSE licensees that hedge to protect the value of their portfolios against adverse foreign currency movements to regularly monitor the impact of movements in the rates of foreign currency on the liquidity position of each investment option. Portfolio and liquidity stress testing programs should factor in the risks and implications of exchange rate

**SUPERANNUATION INDUSTRY OVERVIEW**

volatility and the effects of currency movements on fund cash flows should be considered within liquidity management plans.

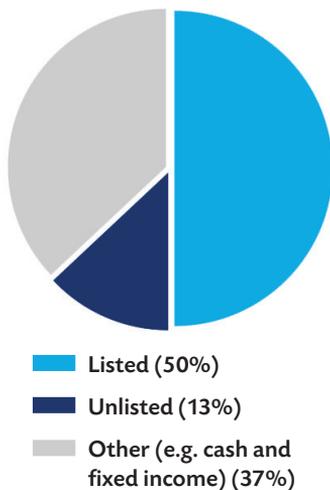
As at December 2014, the majority of investments of RSEs were held indirectly (Figure 9).

Figure 7 - RSE asset allocation (December 2014)



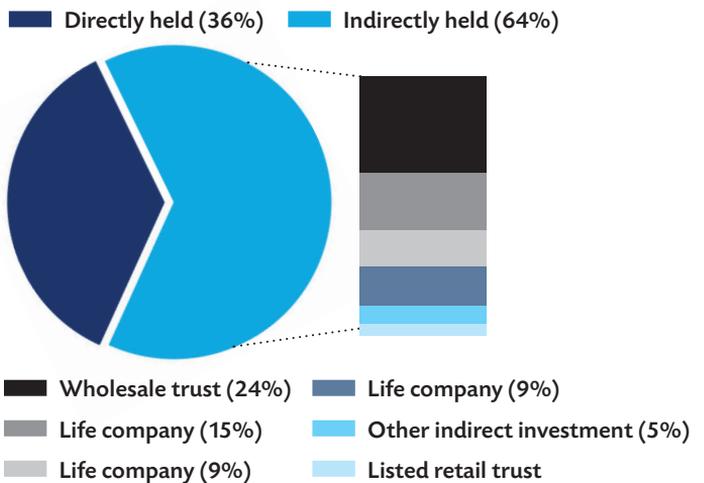
Source: APRA Statistics

Figure 8 - RSE asset allocation by listing (December 2014)



Source: APRA Statistics

Figure 9 - RSE asset allocation by manner of investment (December 2014)



Source: APRA Statistics

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**SUPERANNUATION INDUSTRY OVERVIEW**


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## Member flows

### Net contribution flows

The total superannuation industry received \$44.2 billion in net contribution flows in the 12 months to June 2014, marginally lower than in the previous year. Net contribution flows for RSEs increased by 18 per cent to \$37.4 billion (Figure 10); by contrast, net contribution flows of small funds<sup>8</sup> declined by 55 per cent over the same period. This largely reflects a significant escalation in benefit withdrawals from the SMSF sector, combined with a decline in contributions. RSEs received a further \$18 billion in net contribution flows in the second half of the calendar 2014 year.

As at June 2014, approximately 41 per cent of all APRA-regulated RSEs had negative contribution flows. Despite the strong net contribution flows into the APRA-regulated sector as a whole, this highlights the wide diversity of experience across individual RSEs.

As the industry matures and more is paid out in benefits, net contribution flows are expected to decline, and the prevalence of individual RSEs with negative net contributions is expected to increase. RSEs that have, or expect to have, declining or negative net cash flows as a result of ageing membership need to consider their investment strategies carefully to ensure that they have sufficient liquidity to meet these outflows.

## Contributions

Total industry contributions increased by 3 per cent to \$119 billion in the 12 months to June 2014. Contributions into RSEs increased by 9 per cent to \$95.2 billion (Figure 11); by contrast, contributions into small funds fell by 13 per cent over this period. RSEs received an additional \$50 billion in the second half of the 2014 calendar year. Superannuation Guarantee (SG) contributions comprised just over half of all contributions into these funds. Overall, contributions are expected to continue to remain resilient, given the planned increases in the SG rate.

## Benefit payments

Total benefit payments increased by 13 per cent to \$83.9 billion in the 12 months to June 2014. Benefit payments from RSEs increased by 7 per cent to \$54 billion (Figure 12); by contrast, benefit payments from small funds increased by 25 per cent over this period. RSEs paid an additional \$30 billion in benefits in the second half of the calendar 2014 year, an increase of 8 per cent from the same time last year. Benefit payments will continue to grow as the system matures.

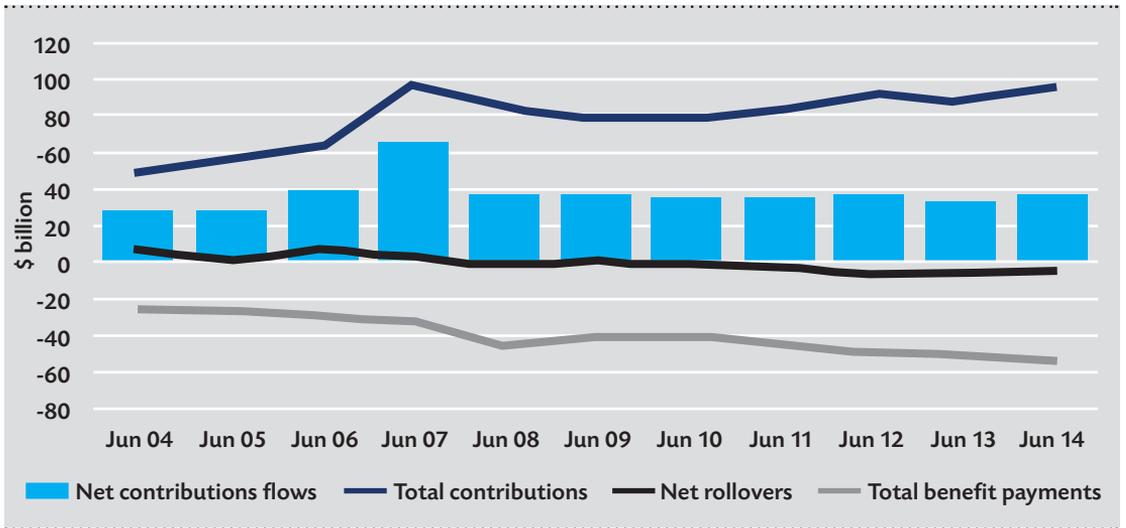
As at December 2014, lump sums comprised 52 per cent of total benefit payments for RSEs. Evidence presented by the Actuaries Institute of Australia has indicated that around 80 per cent of money taken as a lump sum is re-invested in some other form of retirement income product.<sup>9</sup>

<sup>8</sup> In this article, small funds include small APRA funds (SAFs), single member approved deposit (SMADFs) and self-managed superannuation funds (SMSFs).

<sup>9</sup> Actuaries Institute, Submission to Treasury's Review of Retirement Income Stream Regulation, 22 September 2014.

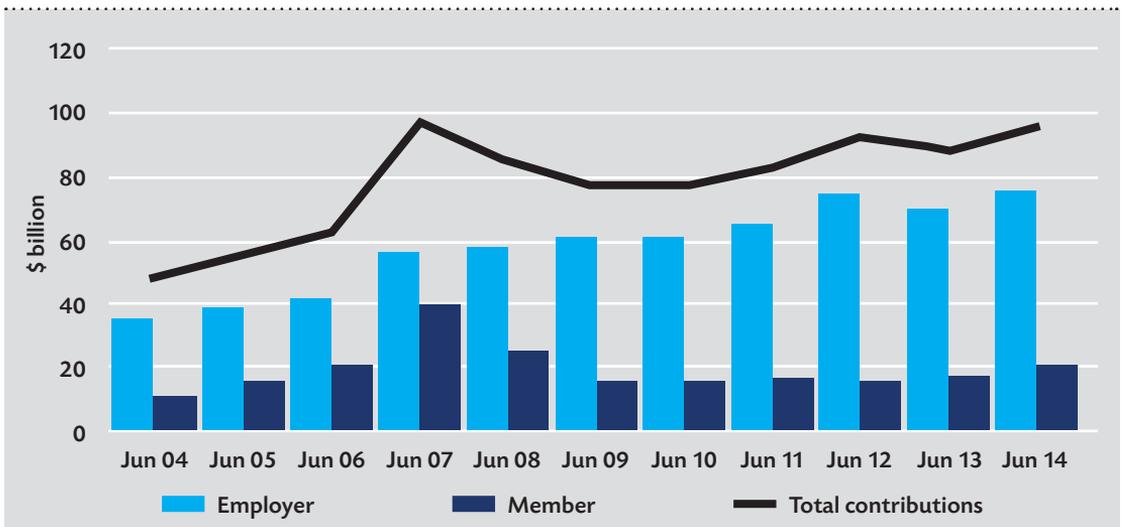
**SUPERANNUATION INDUSTRY OVERVIEW**

Figure 10 - RSE net contributions flows



Source: APRA Statistics

Figure 11 - RSE contributions

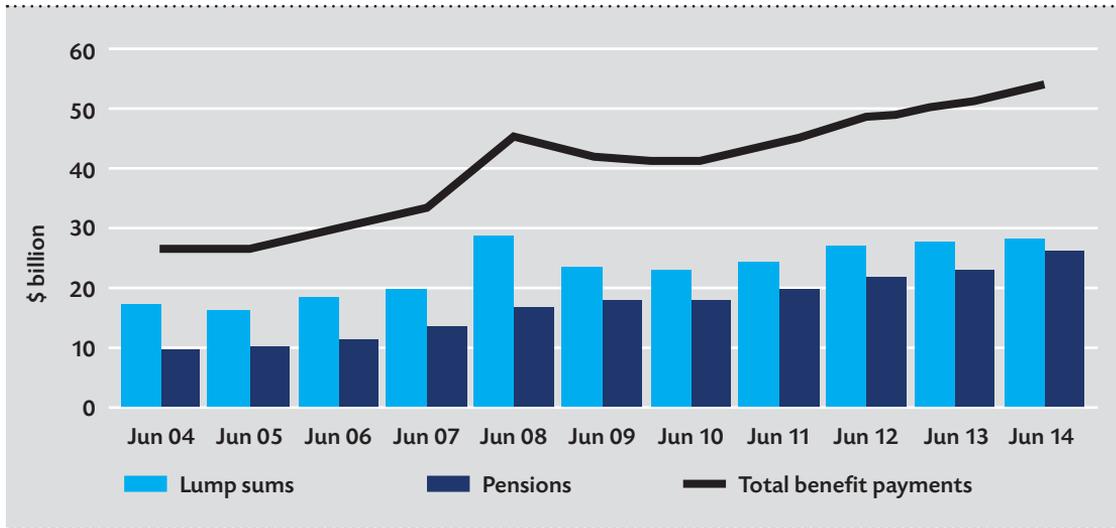


Source: APRA Statistics

## INSIGHT ISSUE ONE 2015

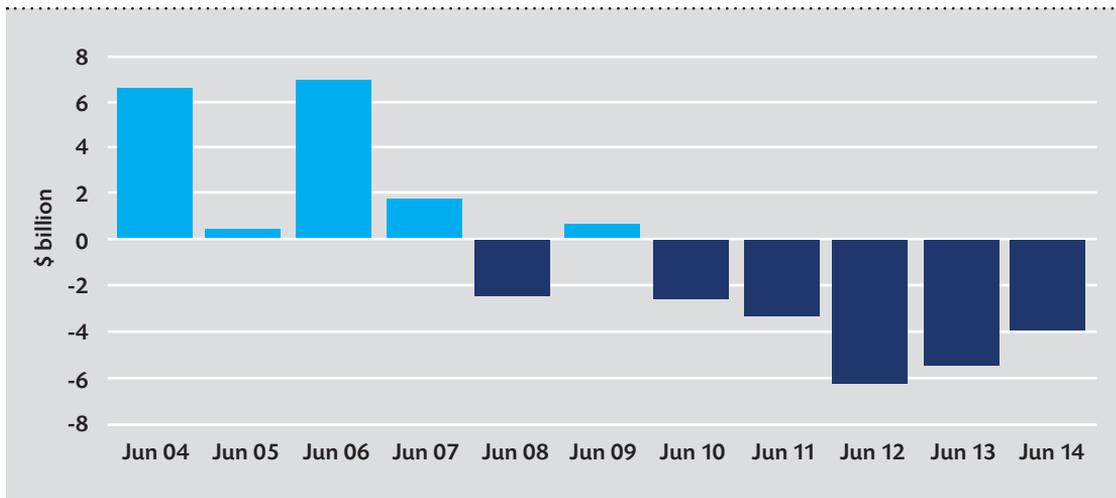
## SUPERANNUATION INDUSTRY OVERVIEW

Figure 12 - RSE benefit payments



Source: APRA Statistics

Figure 13 - RSE net rollovers



Source: APRA Statistics

## SUPERANNUATION INDUSTRY OVERVIEW

The FSI recommended that the goal of the superannuation system should be on the provision of adequate income in retirement. At present, the choice of retirement income products that also address various risks at retirement, such as sequencing and longevity risks, is limited due to current policy settings as well as member preferences and approaches adopted by RSE licensees. Any new products that may be developed to address retirement risks will necessitate careful consideration of the needs of the members. APRA will be looking for evidence of a robust governance and oversight of these products, especially where external providers are involved, and adequate consideration and management of risks relating to benefit design, investment strategy implications (including liquidity) and administrative aspects of proposed new offerings.

### Net rollovers

Net rollovers for RSEs have remained negative since 2010. However, the quantum of outflows fell by 28 per cent to \$4 billion over the 12 months to June 2014 (Figure 13). A further \$2 billion in net rollovers left the APRA-regulated sector in the second half of the 2014 calendar year. The vast majority of these outflows comprised transfers to SMSFs. As at June 2014, approximately 65 per cent of APRA-regulated RSEs experienced negative net rollovers.

Although the volume of net rollovers has reduced in aggregate, some RSEs have experienced significantly higher negative rollovers compared to others. Given the potentially significant and often unpredictable nature of these outflows, funds are expected to evaluate the extent to which they may be susceptible, particularly if a large proportion of members are receiving professional financial advice. APRA expects these considerations to be factored into the liquidity stress testing programs and liquidity management plans.

## Industry performance

### Rate of Return

Based on quarterly data, the annualised rate of return (ROR)<sup>10</sup> for RSEs was 12 per cent for the year ended June 2014. The median APRA-regulated RSE earned an ROR of 11 per cent over the same period. This compares to a median return of 13 per cent in the previous year. Reflecting weaker investment markets, the annualised ROR for RSEs declined to 8 per cent as at December 2014.

### Operating expenses

Aggregate administration and operating expenses for RSEs have continued to rise. Over the 12 months to June 2014, RSEs experienced an aggregate increase in administration and operating expenses of 8 per cent, to \$5.9 billion. However,

<sup>10</sup> Rate of return (ROR) equals net earnings after tax divided by cash flow adjusted net assets. Year ended RORs are calculated by geometrically linking the quarterly RORs, i.e. Year ended ROR =  $(1 + ROR_{t-3}) \times (1 + ROR_{t-2}) \times (1 + ROR_{t-1}) \times (1 + ROR_t) - 1$ .

## INSIGHT ISSUE ONE 2015

## SUPERANNUATION INDUSTRY OVERVIEW

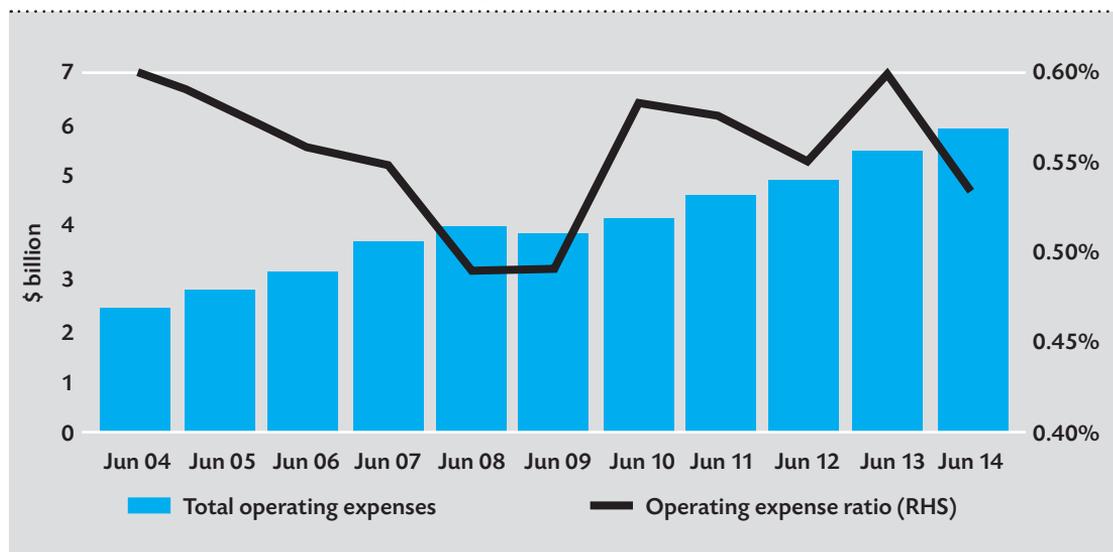
the operating expense ratio declined in 2014, reflecting the faster rate of growth in cash flow adjusted net assets (Figure 14). The operating expense ratio declined marginally to 0.53 per cent in the decade to June 2014 reflecting only marginal efficiency gains achieved by the industry. Compliance and system costs associated with the implementation of superannuation reforms<sup>11</sup> have contributed to the increase in the industry's cost base over the recent years. RSE licensees have also been allocating larger budgets to support brand recognition and member education, to establish internal investment management teams and to deploy complex membership data analytics.

## Membership profile

The membership of RSEs has continued to age gradually. The percentage of members over 50 increased from 27 per cent to 29 per cent over 2013/14, compared to 22 per cent in 2005 (Figure 15). The percentage of benefits vested with members over 50 is now 63 per cent, an increase from 56 per cent in 2005.

Understanding the demographic profile of fund membership is an important step to ensuring that the products offered within the fund are tailored to the risk and return preferences of fund members and that the fund's investment strategy provides for adequate liquidity to meet any member-initiated payments.

Figure 14 - RSE administration and operating expenses



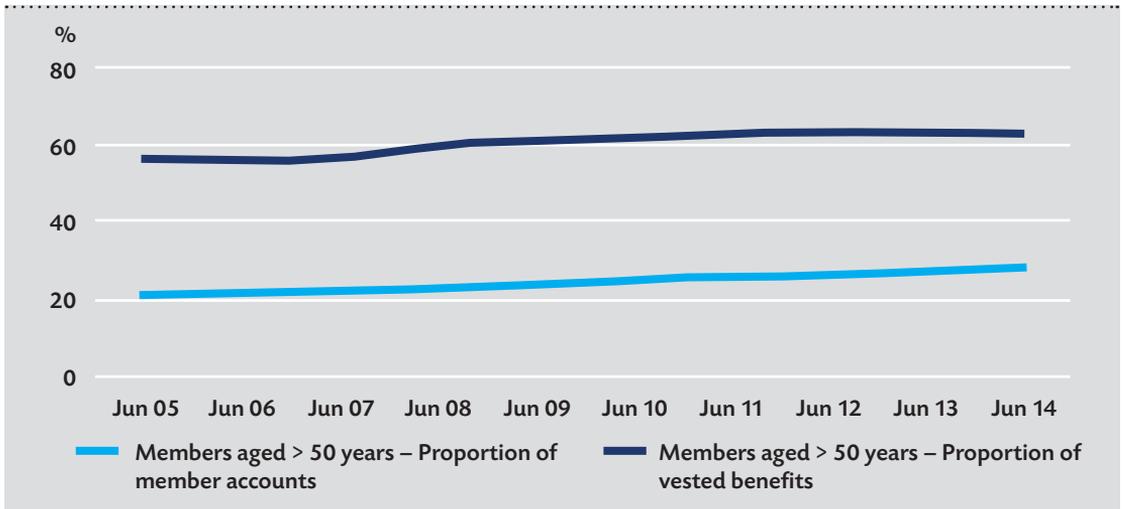
Source: APRA Statistics<sup>12</sup>

11 This includes the implementation of prudential and reporting standards, SuperStream and MySuper development and authorisation.

12 Administration and operating expenses include expenses that relate to the operation of the fund. Inclusive of both flat dollar fee amounts and percentage based fees.

## SUPERANNUATION INDUSTRY OVERVIEW

Figure 15 - RSE members aged 50 and over



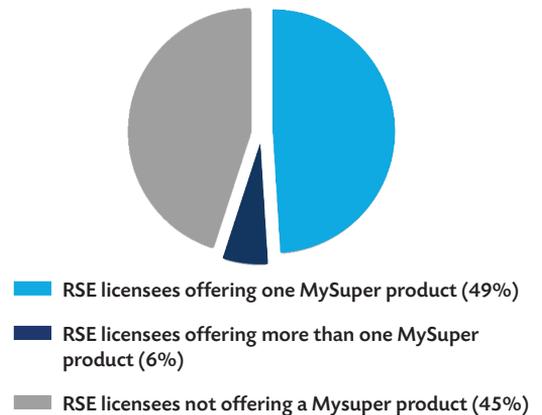
Source: APRA Statistics

## MySuper

The MySuper licensing process commenced in 2013, with products able to be offered by authorised RSE licensees from 1 July 2013. From 1 January 2014, all default superannuation contributions were required to be paid into authorised MySuper products.

As at December 2014, there were 116 MySuper products offered by authorised RSE licensees. Of the total of 164 RSE licensees, 90 RSE licensees (55 per cent) offered MySuper products, with ten of these RSE licensees (6 per cent) offering more than one product (Figure 16).

Figure 16 - MySuper products by RSE licensee (December 2014)



Source: APRA Statistics

## INSIGHT ISSUE ONE 2015

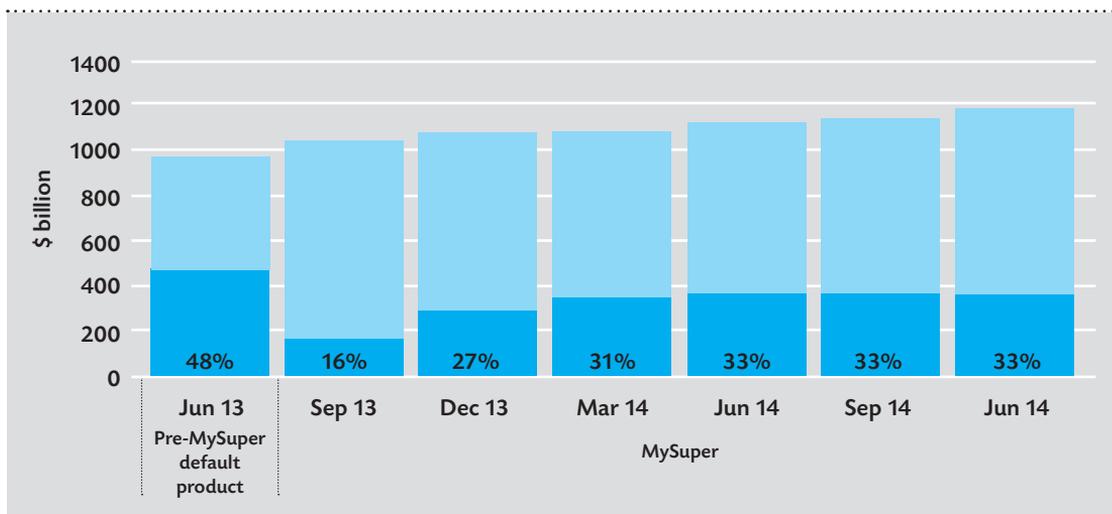
## SUPERANNUATION INDUSTRY OVERVIEW

Total MySuper assets grew by 37 per cent, to \$0.4 trillion, in the 12 months to December 2014. The proportion of total RSE assets in MySuper products increased to 33 per cent by December 2014. This compares to 48 per cent of total RSE assets allocated to pre-MySuper default options as at June 2013 (Figure 17).

Total accrued default amounts declined from \$222 billion (22 per cent of RSE assets) to \$72.5 billion (6 per cent of RSE assets) in the 15 months to December 2014. APRA will continue to monitor the transition of remaining accrued default amounts into MySuper products over the period to 1 July 2017.<sup>13</sup>

As at December 2014, 99 per cent of total MySuper assets were invested in generic MySuper products, with the balance invested in large employer MySuper products. Approximately one third of total assets in MySuper products were invested in products with a lifecycle strategy (Figure 18). Approximately one quarter of all MySuper products (28 out of 116 products) offered a lifecycle investment strategy, while 88 products offered a single diversified investment strategy (Figure 19).

Figure 17 - MySuper as percentage of total RSE assets



Source: APRA Statistics

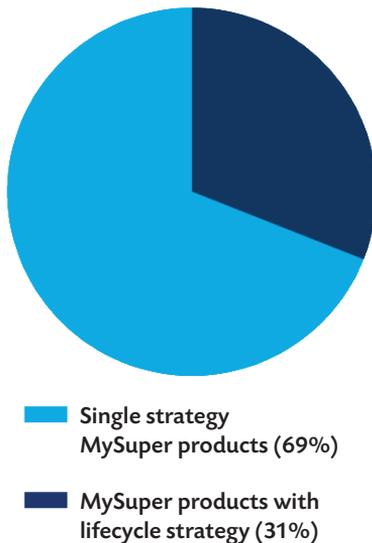
<sup>13</sup> RSE licensees have until 1 July 2017 to identify and transition all accrued default amounts to suitable MySuper products.

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**SUPERANNUATION INDUSTRY OVERVIEW**


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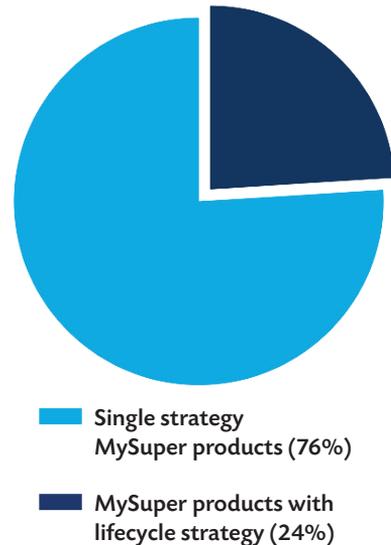
Figure 18 - Assets of MySuper products by product type (December 2014)



Source: APRA Statistics

Lifecycle strategies are more prevalent among retail funds, although some industry and public sector funds also offer them. The key feature of a lifecycle product is its ability to adjust to the changing risk profile, time frame and risk tolerances of a member along their journey towards and into their drawdown phase. However, various risks associated with lifecycle investing, including sequencing risk, complexity of design and administration

Figure 19 - Number of MySuper products by product type (December 2014)



Source: APRA Statistics

and difficulty in comparing and benchmarking performance, necessitate strong governance and prudent management by RSE licensees.

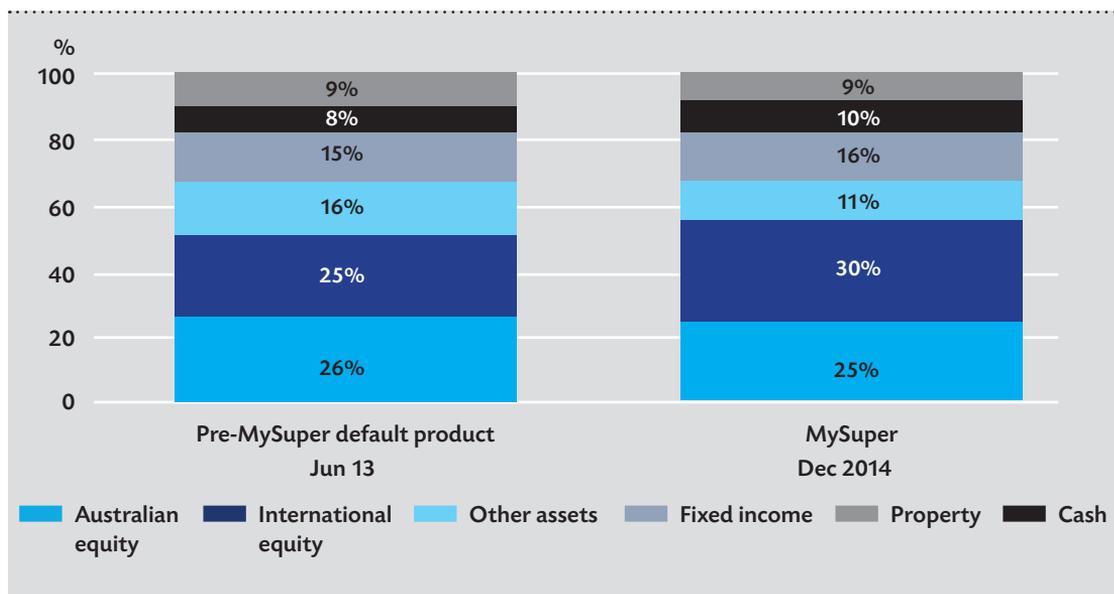
MySuper products had greater allocation to growth assets compared to the overall population of RSEs. This is consistent with the fact that members in choice products tend, on average, to be older and pursue more conservative strategies.

## SUPERANNUATION INDUSTRY OVERVIEW

As at December 2014, 55 per cent of the total investments of MySuper products were allocated to equities (of which 49 per cent were allocated to listed and 6 per cent to unlisted equities), 16 per cent to fixed income and 10 per cent to cash. The remaining assets comprised 9 per cent in property, 7 per cent in infrastructure and 4 per cent in other assets, including commodities (Figure 20).

MySuper products also had a higher proportion of assets invested overseas (40 per cent) compared to the overall population of RSEs, with comparatively higher hedging levels. Unlisted assets comprised approximately 19 per cent of total MySuper investments, which compares to 13 per cent for RSEs. This is attributable to the fact that many select investment options are single sector, and that single sector options rarely provide exposure to unlisted assets.

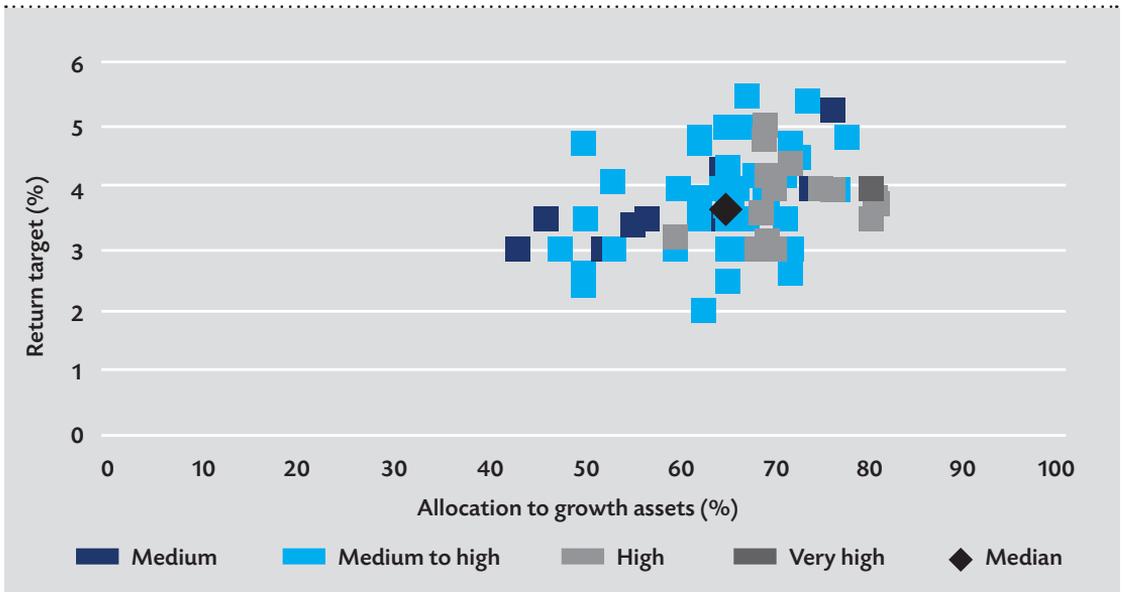
Figure 20 - MySuper asset allocation



Source: APRA Statistics

## SUPERANNUATION INDUSTRY OVERVIEW

Figure 21 - Single MySuper strategies by risk label (December 2014)



Source: APRA Statistics

APRA has observed significant divergence in the risk, return and asset allocation characteristics of MySuper products. Based on the information submitted to APRA, a member in a MySuper product with an allocation to growth assets in the range between 60 and 80 per cent that is commonly found in balanced portfolios is estimated to experience from two years to six or more years of negative returns within any 20 year period<sup>14</sup>. Similarly, return targets for these MySuper products range from Consumer Price Index (CPI) + 2 per cent to CPI + 5.5 per cent (Figure 21).<sup>15</sup>

It is important that there is consistency between the return target and the underlying investment strategy for each MySuper product, and that the communication to members of the level of risk for the product is accurate. APRA will be looking further into RSE licensees' practices in this area as part of its supervisory activities, seeking to understand why, for example, a medium risk MySuper product appears to have a return target and exposure to growth assets that is more consistent with what would be expected for a high risk product.

<sup>14</sup> Refer to s. 1017BA(2)(a)(iv) of the Corporations Act and r. 7.9.07V(1) and (2) of the Corporations Regulations (for requirements relating to the level of investment risk) and r. 7.9.07V(3) of the Corporations Regulations (for requirements relating to the relevant risk label).

<sup>15</sup> Return target represents the mean annualised estimate of the percentage rate of net return that exceeds the growth in the CPI over ten years. Reference: Corporations Act 2001, s. 1017BA(2)(a)(i), Corporations Regulations 2001, r. 7.9.07R.

## INSIGHT ISSUE ONE 2015

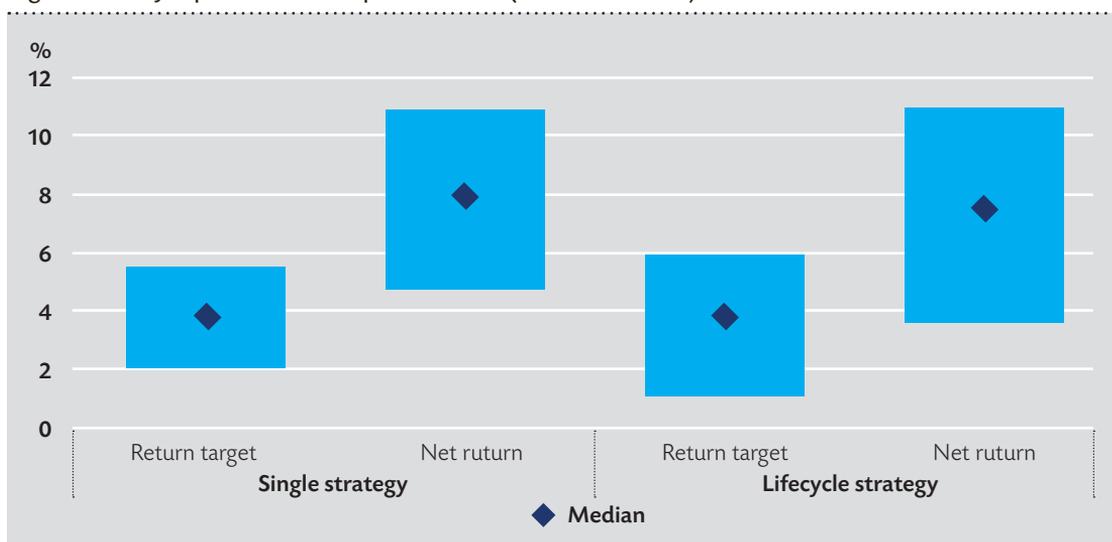
## SUPERANNUATION INDUSTRY OVERVIEW

The median single strategy MySuper product delivered a net representative member return of 7.9 per cent<sup>16</sup> over the 12 months to December 2014, which exceeded the median target of 3.8 per cent. The single strategy MySuper product annualised net returns ranged from as low as 4.7 per cent to as high as 10.9 per cent over this period (Figure 22). Most products have outperformed their return targets over the 12 months to December 2014. It is not possible, however, to draw any meaningful conclusions whether MySuper products are likely to deliver

their intended outcomes over the long term based on one year of performance data.

As at December 2014, the median administration fee for a representative member disclosed in the Product Disclosure Statement (PDS) with respect to a MySuper product was 28 basis points, the median investment fee for a representative member was 50 basis points and the median indirect cost ratio was 67 basis points<sup>17</sup>. The median total fees disclosed, which include administration and investment fees and indirect costs disclosed, was 107 basis points (Figure 23).

Figure 22 - MySuper investment performance (December 2014)



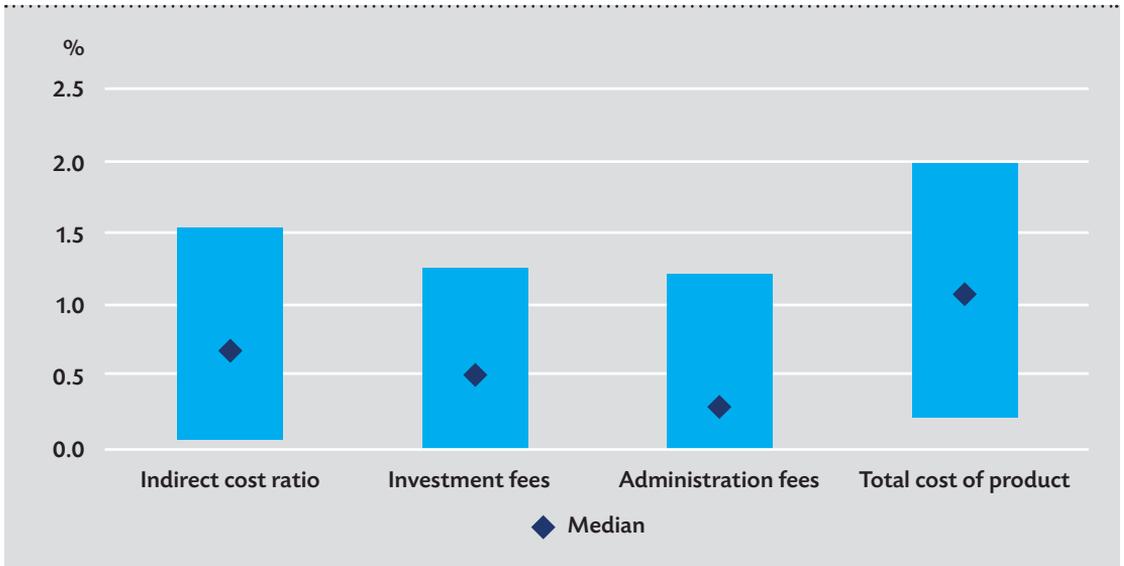
Source: APRA Statistics

<sup>16</sup> Net return of a representative member is the net investment return of a representative member minus administration fees, costs and taxes of a representative member and minus advice fees, costs and taxes of a representative member. Representative member represents a member who is fully invested in the given investment option, who does not incur any activity fees during a year and who has an account balance of \$50,000 throughout that year. Excludes: investment gains/losses on the \$50,000 balance. Median net return only includes strategies for which data has been available for 12 months as at 31 December 2014.

<sup>17</sup> Indirect cost ratio represents the ratio of the total of the indirect costs for a MySuper product or an investment option, to the total average net assets of the superannuation entity attributed to the MySuper product or investment option. Reference cl.104(1) of Schedule 10 to the Corporations Regulations. Administration fee represents a fee within the meaning given in s.29V(2) of the SIS Act, gross of tax obligations, that relates to the administration or operation of the fund. Investment fee represents a fee within the meaning given in s.29V(3) of the SIS Act, gross of tax obligations, that relates to the investment of the assets of the entity. Fees disclosed are prospective fees reported to APRA on Superannuation Reporting Form SRF\_730\_0 – Fees Disclosed.

## SUPERANNUATION INDUSTRY OVERVIEW

Figure 23 - MySuper fees disclosed representative member basis (December 2014)



Source: APRA Statistics

Enhancing the efficiency and performance of the superannuation system, and in particular MySuper products, was one of the areas of focus of the FSI: the wide range of MySuper fees suggests that there is scope for some funds to reduce fee levels and enhance member outcomes. The objective evaluation of efficiency and performance should, however, take into account the overall net outcomes for the members based on a range of factors and not just fund size and fee levels. The range of factors that need to be considered include net returns over the long term, performance relative to the return objective set by the RSE licensee over the long term, the level of retirement income that is delivered and the other benefits and services that are being provided to members.

RSE licensees that offer MySuper products are required to consider annually whether their members are disadvantaged by the fund's "scale" relative to members in other funds that offer a MySuper product. APRA expects RSE licensees to adopt a robust assessment process that considers the measures outlined above to satisfy themselves that their MySuper product meets this test and is in the long-term best interests of their members. This process is new to the industry and it is therefore too early to comment on the range of industry practices in this area, however APRA will be addressing this with RSE licensees as part of its regular supervision activities. APRA will also continue to assess whether RSE licensees offering MySuper products are meeting the enhanced trustee obligations and other relevant legislative requirements for these products on an ongoing basis.

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**SUPERANNUATION INDUSTRY OVERVIEW**

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**Key supervisory issues****Insurance in superannuation**

Provision of group life insurance in superannuation remains an area of heightened supervisory focus for APRA. A range of issues have adversely affected insurance offerings in recent years, including significant increases in insurance premiums for many funds, some capacity limitations in the group risk market and data management issues. The introduction of *Prudential Standard SPS 250 Insurance in Superannuation* (SPS 250) and *Prudential Practice Guide SPG Insurance in Superannuation* (SPG 250) has also required changes in practices and processes to be made by RSE licensees.

In 2014, APRA undertook a thematic review of insurance in superannuation. This review examined the adequacy of governance practices in relation to the provision of insurance benefits to superannuation fund members and the manner in which RSE licensees have been responding to the challenges presented by the current environment and implementation of the new insurance governance prudential requirements. The review indicated that the industry has made substantial progress in implementing the requirements and guidance in SPS 250 and SPG 250, and in addressing the broader market pressures with a view to improving the sustainability of insurance arrangements. Further work is needed, however, to improve practices in a number of areas, including the governance, operational oversight and administration of insurance arrangements.

APRA's observations from the thematic review, and expectations of RSE licensees in addressing the issues identified, are discussed in more detail in a separate article in this edition of APRA's *Insight*.

**Governance and conflicts of interest****Board governance**

The size and complexity of the superannuation industry has increased significantly over the past decade. Given the fiduciary nature of superannuation, strong governance is critically important in achieving the retirement objectives of members. The new *Prudential Standard SPS 510 Governance* (SPS 510), that came into effect on 1 July 2013, introduced heightened obligations for RSE licensees in the area of governance. APRA has stepped up its engagement with boards to ensure that the industry embraces the spirit and the intent of these new requirements.

APRA expects to see evidence of robust discussion and sound understanding of issues by boards. Directors should be proactively involved in all aspects of key decision-making and contribute independently and constructively to the board's decision-making. Prudent boards should continually evaluate the information they are receiving to ensure that it continues to support their decision-making. Boards should be able to demonstrate their strong oversight of policies and processes implemented by management and the manner in which they satisfy themselves that these are operating effectively. Where functions are

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**SUPERANNUATION INDUSTRY OVERVIEW**

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outsourced, boards should insist on comprehensive reporting from their service providers to enable them to stay abreast of the key issues and take ultimate responsibility for decisions.

Effective boards possess a breadth of skills and experience that is commensurate with the complexity of the RSE licensee's operations and which positions them well to respond to strategic challenges. APRA expects RSE licensees to adopt robust and transparent selection, appointment and review processes for directors and undertake regular board and director performance appraisal processes to ensure that the board is operating effectively and able to meet its obligations to members. APRA expects boards to have an effective renewal process that is implemented in practice and seeks to ensure the level of expertise, skills and strategic input required is in place. There should also be a clear focus by boards on identifying and adequately managing conflicts of interest and duty.

The FSI has recommended that RSE licensees should be mandated to have a majority of independent directors on the board of corporate trustees of public offer funds, including an independent chair. APRA's experience across all regulated industries is that the inclusion of independent directors brings additional perspectives and objectivity to board processes and decision-making, enhances the range of skills available and contributes to sound governance outcomes. Independent directors are also often better placed to hold themselves and other directors accountable for their conduct, especially

in relation to managing conflicts. Irrespective of any changes that the Government may make to requirements for composition of superannuation boards, APRA will continue to encourage RSE licensees to consider the value that the appointment of independent directors may bring to the board.

APRA will also monitor the disclosure of director and executive remuneration to ensure it is complete and accurate and meets the enhanced transparency obligations imposed on the industry.

### **Conflicts management**

Conflicts management is another area of significant ongoing attention for APRA. A new *Prudential Standard SPS 521 Conflicts of Interest* (SPS 521) took effect in 1 July 2013 setting out heightened requirements for the management of conflicts of interest and duty. In 2014, APRA undertook a thematic review to assess the industry's progress towards implementation of these requirements. The review revealed significant differences in the quality of management of conflicts across the industry and the need for many RSE licensees to improve their practices. A letter to the industry, issued on 19 March 2015, outlined the findings from the review and APRA's expectations of RSE licensees' in relation to management of conflicts.

More information on this topic and the thematic review outcomes is set out in a separate article in this edition of APRA's *Insight*.

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**SUPERANNUATION INDUSTRY OVERVIEW**

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**Risk governance and culture**

APRA has long paid close attention to risk governance in superannuation. The introduction of *Prudential Standard SPS 220 Risk Management* (SPS 220) from 1 July 2013 imposed a requirement on boards to develop and implement a robust risk management framework. While many RSE licensees have taken steps to meet APRA's expectations, industry practices continue to evolve, particularly in terms of how RSE licensees define and achieve a robust risk culture. In APRA's view, some in the industry have yet to demonstrate that they have a sound understanding of the difference between risk management and compliance.

There is also scope for boards to further enhance risk appetite statements to achieve more balance between qualitative and quantitative assessment of risk. APRA expects boards to ensure that risk appetite and risk tolerance form part of a board's strategic considerations, planning and decision-making and are embedded in an RSE's operations. Boards should be able to formulate and articulate a clear view on the level of risk that the business is prepared to accept and ensure that prompt action is taken where risk exceeds approved limits.

A strong risk culture is integral to sound risk management. A robust compliance framework to ensure adherence to regulatory requirements is important, but not sufficient, to demonstrate sound risk governance. APRA expects to see greater attention by RSE licensees on the importance of risk culture in supporting continued improvement in risk management frameworks and practices. APRA is looking for RSE licensees to develop a risk culture and approach that is focused

on identifying and effectively managing risks, and which seeks to meet the spirit and intent of the prudential requirements. Boards should provide strong oversight and challenge to management to ensure that a sound risk culture is established and embedded across the organisation.

APRA will continue to encourage the industry to move towards better practice in these areas.

**Investment governance**

Strong investment governance is critical to the delivery of optimal financial outcomes for members. The continued economic uncertainty and persistent low interest rate environment make it increasingly difficult for RSE licensees to achieve their risk/return objectives. The need to meet member expectations is leading many funds to increase the number of investment options they offer and the investment activities undertaken in-house. The allocation to overseas assets and the use of lifecycle investment strategies have also been increasing. These investment-related developments necessitate stronger investment governance practices.

Over the last 12 months the industry has been focused on the implementation and embedding of *Prudential Standard SPS 530 Investment Governance* (SPS 530), that came into effect on 1 July 2013. Many RSE licensees have embraced the new standard and have taken steps to enhance their practices to meet the heightened expectations set out in the prudential standard. Boards have generally improved their approach to setting investment objectives, implementing investment strategies and monitoring performance of strategies against objectives. Some boards,

**SUPERANNUATION INDUSTRY OVERVIEW**

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however, continue to demonstrate a lack of understanding of underlying investments, over-reliance on service providers and significant weaknesses in their investment governance and risk management frameworks.

APRA continues to reiterate that RSE licensees seeking to in-source investment management functions need to ensure that they have appropriate governance arrangements in place and the right skills and resources to manage and monitor these investments.

The requirement to undertake portfolio stress testing is relatively new to the industry and more work is needed to implement and embed this requirement. APRA's experience suggests that many RSE licensees still view stress testing as a compliance exercise rather than a useful risk management tool. Frequently, there is an observed disconnect between stress testing results and investment decision making. The areas where stress testing practices continue to fall short of expectations include the application of a comprehensive set of forward looking stress scenarios; stress testing at the investment option, as opposed to fund, level; regular, independent validation of stress testing models; continued assessment of the appropriateness of the stress scenarios to reflect the nature of the RSE's investments; appropriate escalation of stress testing results to the board and senior management; and setting clear decision protocols for a given set of outcomes.

Another area of ongoing focus by APRA is appropriate implementation of the requirements of SPS 530 by RSE licensees providing investment options via platforms. The overarching

consideration for these RSE licensees needs to be whether each option is reasonable to offer as an investment for superannuation purposes. Platform providers must also ensure that a member is able, using only the options on the menu, to build a diversified portfolio for themselves. APRA expects RSE licensees to conduct an effective due diligence on each product that supports a platform option to determine what each option is actually invested in, and to understand the drivers of investment risk and return and its liquidity profile. Platform providers should also be able to demonstrate that there are appropriate investment management arrangements in place for each option.

Further, APRA expects RSE licensees that offer options on a platform to have a robust process to monitor the options for ongoing appropriateness. This includes conducting periodic stress tests at an option level and regularly assessing the liquidity position of each option. RSE licensees should have in place processes that enable them to detect options that underperform or are no longer 'true to label' and have policies and processes in place to terminate investment options, if necessary. APRA also expects RSE licensees to consider and document approaches to managing conflicts which may arise in operating a platform.

RSE licensees that offer to act as trustee for other scheme operators need to be mindful of the risks of such an arrangement, and manage those risks appropriately. APRA expects RSE licensees to have a thorough knowledge of all funds for which they have responsibility and to be acting in the best interests of members.

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**SUPERANNUATION INDUSTRY OVERVIEW**

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**Liquidity management**

A range of factors necessitate sound liquidity management by RSE licensees, including the transition from the accumulation to the retirement phase, the outflow of funds to the self-managed sector, the growing allocation to illiquid assets such as infrastructure in funds' investment portfolios, and the requirement for rollovers to be processed within three days.

SPS 530 requires RSE licensees to develop and implement a liquidity management plan that measures and monitors liquidity on an ongoing basis. It also requires RSE licensees to identify the circumstances that would lead to a liquidity event and consider how the liquidity of investment options can be managed in a range of stress scenarios. Many RSE licensees appear to have difficulty defining a 'liquidity event' and appropriately considering the liquidity profile of different assets in their liquidity stress test assumptions and modelling.

There is considerable variation in the liquidity management practices adopted by RSE licensees and, in some cases, inadequate understanding of what is expected to meet the requirements in the prudential standard in this area. APRA has commenced a liquidity stress-testing thematic review to gain greater insights into liquidity management and stress testing practices, and assess these against the requirements and expectations set out in SPS 530. Some of the areas of focus for this review include the linkages between the results of liquidity stress testing and liquidity contingency planning and investment decision-making processes. The thematic review

will enable APRA to provide feedback to the industry on better practices and areas for further improvement.

**Remaining elements of superannuation reforms****SuperStream**

The Government deferred the implementation of the SuperStream contributions data standards until 1 July 2015 to provide some flexibility to the industry to make the necessary systems changes and to better manage the risks and costs associated with the implementation. APRA has been working closely with the ATO to ensure the smooth and effective implementation of these standards. In May 2014, APRA and the ATO jointly wrote to all RSE licensees to clarify the timeframes and key responsibilities in relation to contributions data and processing, including the expectation that breach reporting is not necessary in the period to 30 June 2015. To assist industry during this implementation period, APRA also announced that the collection of data to be used by Treasury and the ATO to measure SuperStream outcomes will not commence until 1 July 2015. APRA is the agency responsible for administering the provisions of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) that require RSE licensees to comply with the SuperStream standard for contributions and will be monitoring ongoing compliance with these requirements as part of its supervision activities.

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**SUPERANNUATION INDUSTRY OVERVIEW**

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**Data collection**

In October 2014, RSE licensees lodged the first set of annual forms required under APRA's new statistical collection and have also reported for the first time on some quarterly forms which introduced a range of new reporting concepts. APRA supported the industry's transition to the new reporting standards by temporarily extending lodgement due dates and deferring some components of the new collection. APRA also conducted information briefings with the industry and issued a large number of FAQs to clarify the reporting requirements. APRA has been generally satisfied with the implementation of the new reporting requirements but expects there to be improvement in the quality of the data that is reported over time. APRA recently released revised reporting standards incorporating the guidance previously issued through the FAQs and also released a small number of revised reporting standards for further consultation. APRA will continue to guide the industry through the implementation of the remaining elements of the revised reporting framework and any further changes that are made to it.

**Conclusion**

Superannuation industry assets increased over 2014, buoyed by good investment performance and steady net contributions.

The implementation of MySuper products proceeded reasonably smoothly over the year; reporting to APRA indicates that the available products have a wide range of return targets, fee levels and risk profiles. Most products outperformed their return targets over the 12

months to 31 December 2014. Over the coming year APRA will be assessing the robustness of the approach being taken by RSE licensees to the annual 'scale' assessment and ongoing compliance with the enhanced obligations for RSE licensees offering MySuper products.

The focus of RSE licensees over the year has continued to be on embedding the new prudential and reporting standards that came into effect from 1 July 2013, and other elements of the Stronger Super reforms such as SuperStream requirements for contributions processing.

APRA's efforts over the year have also been directed towards ensuring the effective implementation by the industry of the recent reforms, and this will continue to be a primary focus of APRA's supervisory activities in the year ahead. While reasonable progress has been made in some areas, there remain many areas where industry practice needs to be strengthened. In particular, APRA will continue to encourage stronger governance by boards, with a focus on ensuring a sound risk culture and robust approach to risk management, a sustainable approach to insurance and strong investment governance and liquidity management.

# CONFLICTS OF INTEREST THEMATIC REVIEW

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This article provides an overview of the key findings and  
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considerations of APRA's thematic review into the superannuation  
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industry's implementation of *Prudential Standard SPS 521 Conflicts*  
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*of Interest.*  
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## CONFLICTS OF INTEREST THEMATIC REVIEW

### Introduction

The effective management of conflicts of interest has increased in importance in recent years as the superannuation industry has grown in size and complexity. Recent regulatory changes have also raised challenges for boards of Registrable Superannuation Entity (RSE) licensee's, individual directors and other responsible persons in understanding their legal obligations in relation to conflicts management, and ensuring compliance with those obligations.

Under the *Superannuation Industry (Supervision) Act 1993 (SIS Act)*<sup>1</sup>, an RSE licensee is required to ensure, where a conflict arises and has not been avoided, that the duties to and interests of beneficiaries receive priority over any duties to and interests of other persons. *Prudential Standard SPS 521 Conflicts of Interest (SPS 521)* requires the identification, avoidance and management of conflicts of duty and interest by an RSE licensee, and that the board of an RSE licensee take ultimate responsibility for having a conflicts management framework (CMF) that is appropriate to the size, business mix and complexity of its operations.

The standard also requires the RSE licensee to develop, implement and review a conflicts management policy (CMP) that is approved by the board; identify all relevant duties and interests; and develop registers of relevant duties and interests (registers). The supporting Prudential Practice

Guide, *Prudential Practice Guide SPG 521 Conflicts of Interest (SPG 521)*, provides guidance on APRA's view of sound practice - including the importance of a strong conflicts management culture, the role of the CMF, issues to consider in developing the CMP and registers - in relation to the avoidance and management of conflicts.

In 2014, APRA selected conflicts management as the subject for a thematic review<sup>2</sup>. The concept of thematic supervision work is an important part of APRA's supervision, aimed at improving risk management practices across APRA-regulated industries. Benchmarking and peer analysis is used to provide broader perspectives on practices across the industry.

Conflicts management is an area which APRA has identified as historically not being well managed in the superannuation industry, potentially weakening the governance and operation of superannuation entities. SPS 521 provided a platform on which to base the thematic review, and the scope of the work encompassed understanding current practices for managing conflicts by undertaking targeted prudential reviews, including assessment of policy documents and review of board minutes, as well as meetings with RSE boards and management.

2 A Thematic Review is a supervisory activity focussed on a particular theme or topic on which APRA will engage bilaterally with all, or a selection of, industry entities for the purposes of improving entity and industry practice and attention to a specific risk issue or new element of the prudential framework; engaging directly with entities on APRA's expectations for management of the risk issue or prudential requirement; information gathering on current practice and exploring issues associated with the theme; and/or enabling feedback to industry on identified practice and areas for improvement.

1 Section 52(2)(d)(i) of the SIS Act.

**CONFLICTS OF INTEREST THEMATIC REVIEW**

A total of 37 entities were reviewed during the first half of 2014, encompassing a range of RSE licensees across all industry segments. The review involved an assessment by APRA of how well the entities were meeting their obligations in this area, with around one third of the CMFs reviewed assessed as vulnerable or weak. The reviews followed a similar format to APRA's regular prudential reviews, with review findings provided bilaterally to the individual institutions.

**General observations**

Conflicts management is an integral part of an RSE licensee's risk management framework (RMF). Effective conflicts management is closely linked to having a robust RMF, with the review finding a strong correlation between sound risk culture and effective implementation of the new conflict management requirements.

*Conflicts management is an integral part of an RSE licensee's risk management framework (RMF).*

Those RSE licensees with a stronger focus on, and more robust approach to, the management of risk also tended to implement a more robust CMF that was effectively embedded in their business operations. In these cases, routine practices of the board and management such as meeting agendas, accountability metrics, and risk identification and reporting, included actions that prompted identification and consideration of actual and potential conflicts. The CMF was also well integrated into the overall RMF rather than adopted as a stand-alone process, with appropriate RSE licensee consideration given to the relevant aspects of other Prudential Standards, such as *Prudential Standard SPS 510 Governance*, *Prudential Standard SPS 231 Outsourcing* and *Prudential Standard SPS 220 Risk Management*. Further, it was common for these entities to support implementation of their CMF with the provision of quality training to all staff so that expectations in relation to the approach to conflicts management would be understood and applied throughout the RSE licensee's operations. Others took additional steps to implement initiatives that raised risk awareness and promoted good governance throughout the organisation, further promoting a sound conflicts management culture.

**CONFLICTS OF INTEREST THEMATIC REVIEW**

Those RSE licensees with a less robust risk culture and RMF tended to adopt a more minimalist approach to implementing the prudential requirements, designed simply to comply with, rather than meet the spirit and intent of, the requirements. This compliance-driven approach tended to result in an immature CMF, an overly narrow view on what may be relevant interests and duties and a reactive approach to dealing with conflicts, rather than a process which ensures there is regular and appropriate prior consideration of potential conflicts and circumstances that give rise to a conflict. At times a narrow interpretation of conflicts management was observed, where the focus centred only on the directors and there was little evidence of consideration of conflicts beyond those individuals. In these circumstances it was also common to observe poor recognition of related-party conflicts, poor conflicts management practices (including registers which were deficient or out of date), and a lack of challenge or review from other independent or expert parties such as a conflicts committee, risk management personnel, the RSE licensee secretariat, or external consultants.

*APRA identified some positive developments and examples of good practice in the management of conflicts by RSE licensees.*

The review highlighted that there is a wide range of practice in relation to conflicts management across the superannuation industry. APRA identified some positive developments and examples of good practice in the management of conflicts by RSE licensees. Overall, however, the review indicates that implementation of the requirements is still in its early stages and further steps need to be taken by many RSE licensees to improve their conflicts management practices to meet the requirements of the prudential standard.

An on-going challenge is ensuring that the CMF is embedded within the risk management framework, and appropriately understood and applied by all those involved in the RSE licensee's operations. Regular review by the board and management of the content of registers, and proactive consideration of and response to those conflicts that are identified is a good way to evidence that the organisation is committed to robust conflicts management. While the majority of RSE licensees have now complied with SPS 521 in form, the review highlighted many examples of non-compliance in substance. Of concern were cases where material deficiencies were observed in conflict identification, which in turn led to minimised and inaccurate disclosure. Other examples of deficiencies observed during the review included lack of ownership of the CMF by the board and senior management, poor maintenance of registers, lack of identification of strategic investments as relevant interests, lack of timely updates to registers, and materiality thresholds which were not clear.

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**CONFLICTS OF INTEREST THEMATIC REVIEW**

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## **Specific areas considered in the thematic review**

### **1. Identification of conflicts**

The thematic review indicates a wide range of practice is adopted in relation to the identification of conflicts of interest and duty. Typically, RSE licensees with a strong risk culture, sound risk management practices and a transparent approach to identifying and managing conflicts identified relevant interests and duties and actual and potential conflicts at all levels throughout the RSE licensee's business operations, including at the RSE licensee level, the board, individual directors and other individual responsible persons.

Better practice in this area included detailed policies and procedures that illustrated how potential and actual conflicts are identified and managed throughout the organisation (not just at board level). There was also clarity as to how registers were maintained, how assessments were undertaken, and how review processes operated. Further, there was evidence of how reviews of relevant interests and duties and conflicts were included in the fit and proper declaration process.

Poorer practices included little or no evidence that SPS 521 and related guidance SPG 521 had been considered, which led to material inadequacies in identification of conflicts at board level and throughout the RSE licensee's business operations, out of date registers, and ill-defined roles and responsibilities. There were some instances where obvious conflicts were assessed as not relevant, or not even captured.

Entities which demonstrated better practice addressed both potential and actual conflicts in their CMF, identifying where the conflicts may arise throughout the RSE licensee's business operations and particular individuals who may have such conflicts. In contrast, entities with weaker CMFs and risk management practices did not address potential conflicts, and typically focused on only 'actual' conflicts.

For some RSE licensees, the policies underlying the CMF were narrowly focused on directors and other responsible persons, without giving due consideration to conflicts that might arise at the RSE licensee level: for example, where the RSE licensee has an association with a service provider (such as an investment manager, or administrator). A narrow approach to conflict identification tended to be characterised by a lack of consideration of how these conflicts might be perceived by external stakeholders, and in particular current and potential beneficiaries.

In some cases the conflict identification process relied solely on self-identification by directors or other responsible persons, with no independent review undertaken, for example by the risk function, to ensure that the disclosure was complete and adequate. Where more rigour was applied beyond self-identification, a range of processes and controls were applied, including the use of some form of core compliance function to act as an independent (second line) challenge, use of conflict committees, disclosure at each board and committee meeting and a more active, 'real-time' disclosure policy.

## CONFLICTS OF INTEREST THEMATIC REVIEW

Of particular concern were instances where it was evident that multiple directorships of RSE licensees were either not identified as a relevant interest or relevant duty, or were identified but not considered by the RSE licensee, or the particular director with the multiple directorships, to give rise to an actual or potential conflict. APRA has previously indicated that the board of an RSE licensee is expected to assess the extent to which multiple directorships involve, or could be perceived to involve, conflicts and be able to demonstrate how the best interests of beneficiaries remain at the forefront of decisions being made by directors holding multiple positions. Further, where abstention is deemed an appropriate response to such a conflict, boards must also be able to demonstrate that board effectiveness is unimpeded and that critical decisions can continue to be made. APRA notes that similar considerations may arise where a director of an RSE licensee may hold other roles within the superannuation (or broader financial services) industry, such as directorships of, or senior roles with, other entities within the industry (including with service providers).

*Recording relevant duties and interests enables an RSE licensee to demonstrate that it is taking steps to enable it to identify all actual and potential conflicts...*

### 1.1 Registers of relevant duties and interests

An RSE licensee's register is expected to provide a means to identify potential and actual conflicts of the RSE licensee and its responsible persons and associates. Recording relevant duties and interests enables an RSE licensee to demonstrate that it is taking steps to enable it to identify all actual and potential conflicts of the RSE licensee and of its responsible persons and associates.

Although most RSE licensees had a register in place, the majority of the registers reviewed were assessed as not meeting the requirements of SPS 521, or of the guidance provided in SPG 521. As a result, APRA advised these RSE licensees to amend and update their register(s). Specific examples of duties and interests that were not commonly disclosed in the registers included:

- relevant duties and interests at an RSE licensee level;
- potential or perceived conflicts for directors where the director's nominating or appointing body may have conflicting interests to the interests of beneficiaries;
- relevant duties and interests for responsible persons other than directors, including employment arrangements and incentives provided;
- major shareholdings;
- gifts; and
- family member interests.

## CONFLICTS OF INTEREST THEMATIC REVIEW

### *Good practices:*

- *Determining whether any conflicts are considered to be untenable and should be avoided rather than managed.*
- *Adopting a broad approach to the identification of relevant interests and relevant duties which captures the potential and actual conflicts that might arise at the RSE licensee level as well as the potential and actual conflicts of directors, responsible officers and staff.*
- *Taking into account external stakeholders' perceptions of conflicts of interest.*
- *Undertaking a regular review of registers to ensure their accuracy and relevance.*

## 2. Sound governance structures

Some RSE licensees evidenced robust governance arrangements and implementation of strong board oversight practices. For example, in some better practice CMFs, 'Conflicts of Interest' was a standing agenda item at both board and committee meetings, with responsible persons being required to make a declaration of relevant interests, duties and conflicts at each board and committee meeting.

There were some examples, however, where APRA noted a lack of evidence of conflicts having been considered or declared at board or committee meetings, leading to uncertainty as to how, or whether, conflicts were being effectively

managed. Some RSE licensees also appeared not to have in place adequate training for directors, other responsible persons and staff more broadly on the impact of the new conflicts management requirements.

### *Good practices:*

- *Ensuring that governance arrangements covering conflicts are well embedded throughout the RSE licensee's business operations.*
- *Having consideration of conflicts of interest as a standing agenda item for both board and committee meetings, with directors, committee members and responsible persons required to make relevant declarations in relation to conflicts at each meeting.*
- *Using conflicts management committees to deal with complex or particularly conflicted decisions, for example, where a relationship with a related party results in inherent structural conflicts.*
- *Providing mechanisms for directors to access independent advice about their circumstances to ensure all relevant declarations in relation to actual and potential conflicts are made.*
- *Ensuring directors are complying with their obligation to give priority to duties to and interests of beneficiaries when conflicts arise.*

## CONFLICTS OF INTEREST THEMATIC REVIEW

### 3. Policies, procedures, roles and responsibilities

Some RSE licensees adopted a CMF which clearly articulated how duties of responsible persons should be disclosed, how the registers should be maintained and how conflicts assessments and reviews should be undertaken. These frameworks resulted in actual, potential and perceived conflicts being identified and managed throughout the organisation, not just at board level.

In a number of cases, however, the procedural guidance that underpinned an RSE licensee's CMF lacked sufficient clarity on, for example, what comprised a relevant duty or interest within that RSE licensee's business operations, how materiality thresholds were to be applied and how appropriate checks and controls, from identification through to management and review of conflicts, were to operate. This lack of clarity resulted in inconsistent treatment of duties and interests, and some misreporting and poor management of conflicts. There were also instances where policies were not followed, resulting in inadequate or out-of-date disclosures. APRA also noted cases where there was a lack of clear responsibilities regarding the maintenance and review of the registers, resulting in the registers being static and outdated.

Finally, it was apparent that the principles embodied in some policies and procedures did not appropriately reflect the conflicts management culture and corporate values espoused by the RSE licensee, which affected how well the CMF was embedded into the RSE licensee's business operations.

#### *Good practices:*

- *Ensuring that conflicts management arrangements clearly articulate how duties and responsibilities of responsible persons should be disclosed.*
- *Having clear and complete policies integrated at the Group level and the RSE licensee level, to address gifts, entertainment and remuneration, as well as the consideration of indirect interests (for example, where interests are held by family members).*
- *Ensuring that there are clear links between the CMF and the fit and proper assessments required under Prudential Standard SPS 520 Fit and Proper.*
- *Ensuring that employment, remuneration and incentive arrangements of responsible persons are transparent, disclosed and appropriately managed.*
- *Ensuring that the CMF and the conflict management processes are well supported by the provision of quality training for all directors, responsible persons and RSE licensee staff.*

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**CONFLICTS OF INTEREST THEMATIC REVIEW**


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#### 4. Related party dealings

Robust management of related party arrangements is a critical element of a sound CMF. There was a lack of consistency across the industry, however, in relation to RSE licensees identifying and managing conflicts when dealing with intra-group service and product providers and other related parties. The inconsistencies arose, in part, due to inadequacies in the CMF for these RSE licensees. Where RSE licensee level conflicts were not adequately addressed within the framework, differing and inconsistent practices were applied to the identification and management of related party conflicts.

The conflicts of interest and duty arising from related party transactions were typically structural in nature, that is, they are inherent in the nature of the relationship between the parties. Examples included:

- common directors serving on two or more non-associated/non-related RSE licensee boards;
- common directors on an RSE licensee and non-associated/non-related service provider boards;
- common directors on boards within a conglomerate group;
- use of associated or related party service providers;
- investment in associated or related party funds or Managed Investment Schemes; and
- relationships with promoters.

Where the CMF had captured RSE licensee level conflicts, the identification and management of related party conflicts was often limited to the RSE licensee's assessment of actual conflicts and did not adequately capture potential conflicts. The RSE licensee's inability to fully recognise all relevant conflicts involving related parties appeared to be linked to inadequate definitions within the CMF and the RSE licensee's application and interpretation of those definitions.

Better practice, adopted by some RSE licensees, subjects related party service providers to the same governance and oversight processes as other service providers, including undertaking external review and/or industry benchmarking of the pricing, capability and suitability of the related party. Many CMFs, however, were found to be lacking in their consideration of the new Section 58A and Section 58B of the SIS Act which essentially frees up RSE licensees from previous 'tied' arrangements.

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***Robust management of related party arrangements is a critical element of a sound CMF.***

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## CONFLICTS OF INTEREST THEMATIC REVIEW

### Good practices:

- *Definitions of relevant interests and duties and actual and potential conflicts are sufficiently broad to capture related party dealings where it is appropriate.*
- *Related party arrangements are clearly identified in the CMF, together with the approach to be taken to manage this type of conflict.*
- *Dealings with related parties are rigorously monitored with appropriate consideration of the requirements of the Prudential Standard SPS 231 - Outsourcing*
- *There are agreed protocols for selection, comparison and assessment of material services, specifically assessments are undertaken on an arms' length basis, with appropriate benchmarking of key aspects such as product features and rates.*
- *In conglomerate group structures, there is appropriate input and influence by the RSE licensee over shared services provided by the group.*
- *The CMF gives consideration to the new Section 58A and 58B of the SIS Act, which frees up RSE Licensees from tied arrangements.*

## Conclusion

The effective management of conflicts of interest will continue to be of critical importance as the potential for conflicts of interest to arise is ever present in the superannuation industry. Recent legislative changes and APRA's new Prudential Standard SPS 521 require RSE licensees to identify and effectively manage conflicts to ensure that the interests of members are not compromised. APRA's thematic review indicated, however, that there is a wide range of practice across the industry. Further, many RSE licensees still have a lot of work to do in order to meet the requirements SPS 521, and fall well short of the guidance on sound practice in Prudential Practice Guide SPG 521.

The thematic review indicated that a sound risk culture and strong focus on risk management provides a good foundation for robust conflicts management. There is a need for conflicts management to be better embedded within risk management frameworks. RSE Licensees need to ensure that their conflicts registers are comprehensive, covering not only actual, but also potential and perceived conflicts. They also particularly need to focus attention on the effective management of the conflicts that can arise from related party relationships and transactions with related parties.

APRA has written to all RSE Licensees outlining the results of the thematic review and will continue to focus on conflicts management issues as part of its future supervision activities. RSE Licensees are encouraged to review their current practices and consider what changes may be appropriate to ensure that their CMF moves further towards the better practices identified by the thematic review.

# INSURANCE IN SUPERANNUATION THEMATIC REVIEW

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This article provides an overview of the key findings and  
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considerations of APRA's thematic review into the superannuation  
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industry's implementation of *Prudential Standard SPS 250 Insurance*  
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*in Superannuation.*  
.....

## INSURANCE IN SUPERANNUATION THEMATIC REVIEW

### Introduction

APRA has had a heightened supervisory focus on the group life insurance market for a number of years because of concerns about industry practices. This attention intensified following the deterioration in claims experience for group life insurers and reinsurers. The factors contributing to this situation include increasing levels of default cover being made available without underwriting, poor underwriting controls for optional levels of cover, competitive tender and pricing practices, increased member awareness of their rights to make claims, increased involvement in the claims process of the legal profession, and changing community attitudes to mental health.

As part of the Stronger Super reforms, APRA introduced new prudential standards for the superannuation industry, including *Prudential Standard SPS 250 Insurance in Superannuation* (SPS 250), which came into effect on 1 July 2013. Enhanced trustee covenants relating to insurance benefits to members were also introduced in section 52(7) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act)<sup>1</sup>, including those related to membership demographics<sup>2</sup>, erosion of benefits<sup>3</sup> and the pursuit of claims.<sup>4</sup>

The range of factors outlined above has had significant implications for Registrable Superannuation Entity (RSE) licensees in terms of the cost to members of insured benefits, sustainability of current insurance benefit designs and participation of insurers and reinsurers in group life tenders. It has also heightened the level of risk to insurers, with a consequent impact on their profitability, the premium levels they charge, and the benefit designs made available to RSE licensees.

Given this environment, APRA undertook a thematic review in 2014 to assess how the superannuation industry was implementing the requirements of SPS 250 and the SIS Act covenants. The review covered a cross-section of 33 RSE licensees from all segments of the superannuation industry (industry, retail, corporate and public sector). The review sought to identify areas of better practice and potential areas for improvement.

The review focused on RSE licensees' governance and oversight of the provision of insurance to the members of their RSEs and led to observations across a number of related topic areas, as outlined below.

1 Section 52(7) of the SIS Act.

2 Sub-section 52(7) (a) requires that RSE licensees have regard to the demographic composition of the beneficiaries of the entity in formulating the insurance strategy (membership demographics covenant).

3 Sub-section 52(7)(c) requires that RSE licensees can only offer or acquire insurance if the cost of the insurance does not inappropriately erode retirement incomes of beneficiaries (erosion of benefits covenant).

4 Sub-section 52(7) (d) requires that RSE licensees do everything that is reasonable to pursue an insurance claim for the benefit of a beneficiary, if the claim has a reasonable prospect of success (pursuit of claims covenant).

**INSURANCE IN SUPERANNUATION THEMATIC REVIEW****Governance**

RSE licensees have heightened their focus on insurance arrangements in light of the introduction of SPS 250 and the additional insurance covenants under the SIS Act, together with recent adverse claims experience and consequent higher premium rates for members. This has no doubt contributed to some of the better governance practices in relation to insurance arrangements that APRA observed are now in place for many RSE licensees.

It is widely accepted that the RSE licensee is ultimately responsible for the provision of insured benefits to members and that the board of the RSE licensee is responsible for the insurance management framework (IMF). In practice, however, the board often delegates some aspects of its authority to a board committee, a management committee, or to management more generally to act on its behalf. APRA observed that it was common for at least one committee to operate within an RSE licensee's governance structure to support the board in undertaking its responsibilities pertaining to insurance arrangements.

Two distinct types of committees were observed, although the prevalence and composition of these committees varied across the superannuation industry. The claims committee was the most common, and had responsibility for the review of death and permanent incapacity claims, thereby assisting RSE licensees to fulfil their obligations

under the pursuit of claims covenant in the SIS Act. In addition, some RSE licensees had a committee responsible for the oversight of the IMF, including benefit design, monitoring of service providers and the selection and tender process.

APRA expects that where such governance structures are used, there are clear delegations in place and that regular reporting on insurance matters is provided to the board. For many RSE licensees, the quality of this reporting could be enhanced to provide a more holistic view of insurance arrangements and experience. Such reporting should synthesise the multiple sources of information available to the RSE licensee to provide an overall picture of the insurance arrangements for the board and/or committees. This will assist in enhancing the overall board and committee understanding of insurance arrangements, and associated risks and issues.

There is generally a heightened awareness and involvement by boards and committees in insurance arrangements during periods of tender and renewal activity. Nevertheless, there is room for improving the oversight by the board and committees on the ongoing operation of insurance arrangements and the IMF, outside of the selection, tender and renewal processes.

## INSURANCE IN SUPERANNUATION THEMATIC REVIEW

RSE licensees with related party arrangements (particularly those without a dedicated 'office of the trustee') should also have a clear and robust process for ensuring that their insurance arrangements are conducted on an arm's length basis and are in the best interests of members. Better practices were observed where RSE licensees were engaging an independent adviser to benchmark the insurance arrangement on, at least, a triennial basis to ensure that it is appropriate and in members' best interests.

### *Good practices:*

- *Ensuring that the board and/or committees have appropriate ongoing oversight of the operation of insurance arrangements, outside of the selection, tender and renewal processes.*
- *Reporting to the board and/or committees that provides a holistic view of the insurance arrangements and associated risks and issues.*
- *For related party arrangements, using an independent adviser to benchmark insurance arrangements on a triennial basis to ensure they remain appropriate and in members' best interests.*

## Insurance management framework

The sound governance and management of an RSE licensee's insurance arrangements should be supported by a robust IMF. The IMF encompasses all aspects of an RSE licensee's insurance related business operations, including all systems, structures, policies, processes and people to manage insured benefits available to beneficiaries. The IMF is ultimately the responsibility of the board.

The implementation of the prudential requirements under SPS 250 has led to improvements in IMFs, although the documentation of the IMF continues to be largely compliance focused for many RSE licensees. As a result, the operation of the IMF was an area of weakness identified during the thematic review and further work is required by many RSE licensees to shift to an approach which more effectively embeds the IMF within their business operations.

Some of the areas for continued improvement in the IMF include the processes in place to meet on an ongoing basis the minimum data requirements in SPS 250, the roles and responsibilities of those involved in the oversight of the IMF (including service providers), and the administration arrangements, including the underwriting and claims management processes. RSE licensees should be focused on improving the overall operation and documentation of the IMF to ensure that it encompasses all aspects of the RSE licensee's business operations, having regard to size, business mix and complexity and the types of insured benefits made available.

## INSURANCE IN SUPERANNUATION THEMATIC REVIEW

Further, it is important that there are strong linkages between the IMF and the risk management framework (RMF). This connection should ensure that the RSE licensee's approach to the identification, management and mitigation of risk for the provision of insured benefits is consistent with the risk management approach taken more broadly. Overall, APRA noted that these linkages were generally poor, and the insurance risks identified in the RMF were often narrowly focused.

Whilst APRA does not expect all RSE licensees to have dedicated insurance management resources in place, they should ensure that their business operations and processes provide for adequate oversight of insurance arrangements. A number of larger RSE licensees have been increasing the number and expertise of their management personnel in this area to reflect the increasing complexity of their insurance arrangements.

### *Good practices:*

- *Adopting an approach to the overall operation and documentation of the IMF that is less compliance focused and more effectively embeds the IMF within the RSE licensee's business operations.*
- *Considering the linkages between the IMF and RMF to ensure that the risks relating to the provision of insured benefits are adequately reflected in the RMF and the relevant processes and controls are implemented in the IMF.*
- *Ensuring that appropriate resourcing and processes are in place to support effective oversight of insurance arrangements, having regard to the size, business mix and complexity of the RSE licensee.*

## Insurance benefit design

Insurance benefit design has attracted an increased level of attention by both RSE licensees and insurers as part of the broader response to address the pressures within the group life insurance market and the adverse claims experience in parts of the superannuation industry.

Consideration of the sustainability of insurance arrangements is in its early stages for many RSE licensees, although some are now considering sustainability issues and implementing changes to their benefit design, particularly for new members. These changes are often linked to the end of the rate guarantee period and/or a market tender being conducted. Some RSE licensees have also been prompted to implement changes due to their significantly adverse claims experience and consequent increases in premium rates for members.

Some examples of the changes to benefit designs that have been observed to date include reducing automatic acceptance levels (AALs) and shifting to income stream rather than lump sum total and permanent disablement (TPD) benefits. Some RSE licensees, in consultation with their insurer, have also been tightening TPD definitions.<sup>5</sup>

In supporting changes to the benefit design, RSE licensees generally have a sound awareness of the trustee insurance covenants under the SIS Act, and in particular those relating to consideration of membership demographics and erosion of benefits. RSE licensees' considerations under these covenants are, however, usually only at a

<sup>5</sup> Changes to definitions are being implemented in various ways. For example, the change may be only for future members or it may be only for future TPD events. Practice is expected to evolve.

## INSURANCE IN SUPERANNUATION THEMATIC REVIEW

high level and could be further enhanced. RSE licensees should be able to demonstrate detailed analysis and documented processes to support how decisions in relation to insurance are being made in members' best interests. There is room for enhancement in the quality and depth of RSE licensees' analysis of membership demographics and behaviours when considering any changes to the benefit design to ensure that any changes are appropriate and relevant for the fund membership. RSE licensees recognise the need to consider the erosion of benefits covenant, albeit there are varying approaches to assessing the implications of this covenant for insurance benefit design.

APRA expects RSE licensees to be examining the features of their insurance benefit design which may not be sustainable and/or affordable for members and to appropriately address these matters. In doing this, RSE licensees should have a sound understanding of their membership profile to help form a view on member best interests before implementing any changes to the benefit design. RSE licensees should also be engaged in discussions with their insurer and administrator to ensure the appropriateness and sustainability of the benefit design, and that such a design can be soundly administered. APRA expects that this process for reviewing insurance benefit design will be ongoing, and APRA will be closely monitoring developments in this area.

### *Good practices:*

- *Conducting regular, detailed and comprehensive analyses of membership demographics, insurance needs and insurance costs in order to demonstrate that insurance arrangements meet the requirements of the SIS covenants and are in member's best interest on an ongoing basis.*
- *Engaging with insurers when considering changes to the benefit design to ensure the appropriateness and sustainability of the insurance arrangements. This process should also include discussions with the administrator to ensure that the benefit design can be soundly administered.*

## **Selection and due diligence process**

As industry discussion on the sustainability of insurance arrangements gained momentum over 2014, RSE licensees recognised the need for, and in some cases adopted, a more holistic approach to applying selection criteria. As a consequence, some RSE licensees have begun to shift from focusing on the cost of insurance as the key criterion. Formal and explicit consideration of sustainability issues within the selection criteria more broadly, however, needs to further evolve and become common practice.

Most RSE licensees have determined a range of selection criteria in their IMF in order to assist in the decision making process. The most common criteria focus on technology, member services, product (including terms and conditions, and

**INSURANCE IN SUPERANNUATION THEMATIC REVIEW**

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benefit design), price, risk management practices adopted by the insurer, and the sustainability of the insurance offering and financial strength of the insurer. Some RSE licensees apply weightings to the various selection criteria however these are often determined at the time of the tender and are not well documented in the IMF. It is considered better practice for RSE licensees to develop and document in the IMF benchmarks, and also boundaries in respect of what is not acceptable, to assist in the selection process.

Whilst acknowledging that this is a new and evolving area, RSE licensees' formulation of a claims philosophy as part of the selection and due diligence process has been limited to date. However APRA has observed that RSE licensee (and insurer) awareness has been increasing during the period over which the thematic review has been undertaken. A majority of RSE licensees continue to be heavily reliant on the claims philosophy of their insurer, and such claims philosophies continue to be developed by insurers. APRA considers that both RSE licensees and insurers will benefit from having a mutual understanding of their claims philosophies, and how they drive claims management processes and claims decisions in practice. APRA therefore encourages RSE licensees to articulate their own claims philosophy, and apply it when reviewing the claims philosophy of their existing or prospective insurer.

During the thematic review, a significant number of RSE licensees who had undertaken recent market tenders noted difficulties in conducting these tenders, and in particular challenges in obtaining competitive bids from insurers and reinsurers. RSE licensees should be aware of the need to give to insurers adequate advance notice of a planned tender or renewal process. It is therefore important that RSE licensees have a well-developed approach to the tender process that is documented in their IMF and includes consideration of all relevant aspects of the tender, including selection criteria and data requirements (refer below), and which provides adequate time for the tender to be conducted effectively.

APRA observed a range of approaches adopted by RSE licensees for the tender process, from the use of a benchmarking review to a full market tender. Some larger RSE licensees have also increased their level of engagement with the reinsurer during this process. For the majority of RSE licensees, however, there are often no documented criteria in the IMF to assist in deciding whether or not to conduct a full market tender and/or benchmarking process, having regard to the costs, time and effort involved. The due diligence process for insurer selection could also be further detailed in the IMF.

## INSURANCE IN SUPERANNUATION THEMATIC REVIEW

In conducting any tender process (whether a full market tender or benchmarking review), it was common for RSE licensees to seek assistance from external advisers. However, APRA noted that there is limited evidence of robust selection and due diligence processes in place for selecting third party advisers, and limited guidelines on the use of such advisers in the IMF. APRA also observed that smaller RSE licensees are often heavily reliant on these external advisers to conduct all aspects of the tender and due diligence process. In APRA's view, it is important that RSE licensees are closely involved in determining the assessment criteria, reviewing insurers against these criteria and making the final decision to appoint the insurer.

### *Good practices:*

- *Adopting a holistic approach to the selection of insurers that considers a range of selection criteria such as those outlined above, rather than primarily focusing on price, and which is well documented in the IMF.*
- *RSE licensees developing their own claims philosophy statement, and using it when reviewing the claims philosophy of their insurer or prospective insurer.*
- *Adopting a well-developed approach to the tender process that is documented in the IMF and which ensures that there is consideration of all relevant aspects of the tender, including the use and selection of external advisers, the selection criteria to be applied and data requirements, and which provides adequate time for the tender to be conducted effectively.*

## Monitoring, review and renewal process

Overall, the monitoring, review and renewal processes for insurance arrangements were some of the stronger areas observed during the thematic review, with RSE licensees usually maintaining regular dialogue with both their insurer and administrator. The monitoring process commonly consists of a multi-layered approach, ranging from daily contact between operational level staff to discuss day-to-day administrative matters through to at least quarterly senior management meetings to discuss broader trends and strategic issues.

Monitoring processes and protocols are generally considered to be adequately documented within the IMF. In some cases, however, additional processes and practices existed within the RSE licensee's business operations which were not adequately captured in the IMF, and is an area for improvement.

Many RSE licensees tend to be more focused on the reporting received from their insurers, rather than their administrator, in relation to insurance arrangements. As a result, few RSE licensees reconcile the reporting received from their service providers to provide a more comprehensive and reliable insurance reporting framework. RSE licensees could also be more proactive in seeking additional, qualitative reporting from their insurer and administrator on measures of experience under the insurance arrangements. This will improve RSE licensees' understanding of the performance of the insurance arrangements,

**INSURANCE IN SUPERANNUATION THEMATIC REVIEW**

assist in determining the strategic approach to be adopted during a tender, review or renewal process, and in identifying any changes to the benefit design that may be appropriate.

Typically, RSE licensees undertook a comprehensive triennial review of their insurance arrangements, usually timed to align with the end of the rate guarantee period. Formal consideration of renewal generally occurs following this review, with the tender selection criteria usually being adopted for this process. Generally, RSE licensees' have not determined triggers for an out-of-cycle review, renewal or tender process to be undertaken, or documented these triggers in the IMF.

*Good practices:*

- *Reporting received from the insurer (and administrator) that, in addition to reporting against service level agreements, is sufficiently detailed and regularly reconciled, to provide a comprehensive and reliable insurance reporting framework that supports adequate understanding of the performance of the insurance arrangements.*
- *Determining and documenting in the IMF the triggers that would cause an out-of-cycle review, renewal or tender process.*

**Key contractual arrangements**

The management of key contractual arrangements was an area of weakness identified during the thematic review, and there is a need to lift industry practice in this area.

For the majority of RSE licensees, key contractual agreements are generally executed within a short period prior to the commencement of the insurance arrangements, and legal advice is usually obtained as part of this process. However, in a number of cases, there were long delays in the formal sign-off of key insurance agreements. In addition, delays (albeit of a shorter duration) were also noted with respect to documenting variations to policies and agreements during the term of the arrangement.

These practices result in key contractual agreements not being executed before the insurer is 'on risk'. APRA considers that the absence of an executed insurance policy and any associated agreements materially heightens legal and operational risks, increases the potential for disputes and litigation, and is reflective of poor operational controls. RSE licensees should ensure that key contractual agreements are executed prior to the commencement of the insurance arrangement, and ensure that sufficient time and adequate information is provided within the selection and tender process for this to occur. APRA considers that long delays in this process are an unacceptable industry practice.

## INSURANCE IN SUPERANNUATION THEMATIC REVIEW

Insurance premium rate guarantee periods of approximately three years have been common across the superannuation industry, with some arrangements involving premium adjustment mechanisms that provide for the premium payable to be increased or decreased to reflect claims experience over time. RSE licensees are expected to have a sound understanding of the key drivers of any premium rate changes and the operation of any premium adjustment mechanism that is in place. Following the recent deterioration in claims experience and sustainability issues gaining more prominence, some RSE licensees and insurers are reviewing the operation of rate guarantee periods and premium adjustment mechanisms. Whilst not universal, some changes include the adoption of shorter rate guarantee periods and closer alignment of the interests of RSE licensees and insurers through premium reviews that incorporate an assessment of scheme performance on a more frequent basis.

Both RSE licensees and insurers need to undertake a rigorous assessment of the risks arising from insurance arrangements and have the requisite skills and expertise to manage the arrangements and associated risks, in order to adequately meet the regulatory requirements. Where there is consideration of significant changes to the existing insurance arrangements, RSE licensees and insurers are encouraged to liaise with APRA early in the process.

### *Good practices:*

- *Ensuring that key contractual agreements and policies are executed prior to the commencement of the insurance arrangement. Long delays in this process are an unacceptable industry practice.*
- *Having a sound understanding of the overall pricing arrangements, including the operation of the rate guarantee period, the key drivers for premium rate changes and any premium adjustment mechanisms in place.*

## Data management

Data quality is a persistent challenge for many RSE licensees. Whilst there is an increasing awareness of data integrity issues and the importance of sound data management processes, data management was assessed as the weakest area during the thematic review. APRA's observations have strongly highlighted that the availability of sufficiently detailed, accurate and timely insurance data appears to be lacking across the superannuation industry. RSE licensees should therefore be actively considering their current and future insurance data needs.

Most RSE licensees were focused on meeting the minimum data requirements under paragraph 15 of SPS 250, and have generally taken a compliance-focused approach. The accuracy and completeness of insurance data is the responsibility of the RSE licensee. A prudent RSE licensee should maintain insurance data for as long a period as possible, particularly in

## INSURANCE IN SUPERANNUATION THEMATIC REVIEW

light of more recent extended claims run-off patterns. RSE licensees should also ensure that the insurance data is of sufficient detail and quality for a prospective insurer to properly assess the risk as part of the selection, tender and renewal process. This information should also support an RSE licensee's identification, monitoring and management of the risks of making insured benefits available to members.

There was often an absence of data validations being undertaken to verify and improve the quality of data held, particularly given the multiple sources of data utilised by RSE licensees, such as insurers, administrators, employer sponsors and financial planners.

There should be active engagement by RSE licensees with their insurer and administrator in considering their future insurance data needs. Robust analysis in this area will assist RSE licensees with future re-rates and tenders, benefit design changes, and management of member services. As part of this, RSE licensees should also consider how they will retain and access insurance data in the event of a change in insurer at a future point in time.

Better practices involve developing a broader data management framework (which would include insurance data). This framework would support RSE licenses' responsibilities for maintaining data quality and provide a clear strategy for meeting their data requirements. RSE licensees should be working with their insurer and administrator to identify the relevant insurance data items, maintaining the insurance data in an appropriate and accessible form (including for use in future tenders), and ensuring that there is clarity of roles and responsibilities pertaining to the data management process.

Significant improvements are also needed in the thoroughness and frequency of data verification, testing and cleansing programs, and associated reporting across the superannuation industry. APRA observed that the majority of RSE licensees place a high level of reliance on their administrator and insurer to maintain the insurance data and provide an assurance of data quality, without any independent verification.

Improvements to service providers' reporting on insurance data, and the associated data assurance programs, are encouraged as this is an area that is poorly undertaken by many RSE licensees. In some better practice cases, reporting on insurance data is included within the operational reports provided by insurers and administrators, which is then incorporated in reporting to the board and/or committees.

### *Good practices:*

- *Maintaining data over a longer time than the 5 years required by SPS 250, particularly in light of more recent extended claims run-off patterns.*
- *Regularly assessing future insurance data needs, in consultation with insurers and administrators, to assist with future re-rating, tenders, benefit design changes and member services.*
- *Thoroughly and frequently undertaking data verification, testing and cleansing programs, with an appropriate reporting framework in place.*

**INSURANCE IN SUPERANNUATION THEMATIC REVIEW****Underwriting**

RSE licensees are responsible for the oversight of the underwriting process to ensure that it aligns with the arrangements agreed in the key contractual agreements, and is soundly administered.

APRA observed that the majority of RSE licensees' oversight the underwriting process through the reporting received from their insurer and administrator, albeit this reporting tends to be primarily focused on service standards. APRA considers that substantial improvement is warranted in this area. In addition, further improvements are needed in documenting in the IMF the underwriting process, the processes for oversight and monitoring by the RSE licensee, and the roles and responsibilities of all parties.

In relation to the underwriting functions performed by the insurer, only a few RSE licensees receive reporting on the quality of underwriting decisions, or analysis of underwriting issues and/or trends. Better practices highlighted that additional oversight was undertaken by some RSE licensees through reviewing member complaints about underwriting decisions, reviewing all declined underwriting decisions from the insurer, and reviewing all internal and/or external audit reports (for example, from the reinsurer) on the underwriting process.

Across the industry, it is commonly accepted that administration systems have not been built to accommodate the complexity of insurance arrangements. In recognition of these limitations, some RSE licensees are looking for enhanced system capabilities, including online member application and enquiry capability.

In relation to underwriting, system limitations often prevented the application of any underwriting loadings (for applications outside the automatic acceptance limits) flowing from the underwriting decisions made by the insurer. As a result, many RSE licensees were only able to offer insurance cover on an 'accept or decline' basis. Some RSE licensees have historically waived underwriting loadings, which can create the potential for anti-selection issues. RSE licensees need to assess the impact of these practices on their insurance arrangements, in consultation with their insurer.

*Good practices:*

- *Being aware of, and fulfilling, responsibilities to oversee the underwriting process.*
- *Ensuring that the IMF clearly documents the underwriting process, the processes for oversight and monitoring by the RSE licensee, and the roles and responsibilities of all parties.*

**INSURANCE IN SUPERANNUATION THEMATIC REVIEW****Claims management**

Overall, claims management processes were observed as a collaborative effort between the RSE licensee, administrator and insurer, and rated as one of the stronger areas during the thematic review.

Whilst claims management practices were generally sound, there is still room for improvement in the governance and documentation of the claims management process in the IMF for some RSE licensees. In particular, the IMF should clearly outline roles and responsibilities of all parties. This enables RSE licensees to effectively overlook and manage their service providers' roles, and the risks arising in the claims management process and seek assurances from their service providers that appropriate controls are in place and operating effectively.

Similar to underwriting practices, the limitations of administration systems also impact the claims management process, and contribute to the lengthy periods taken to settle claims. Some RSE licensees have highlighted concerns with the ability of their insurers to process claims in a timely manner due to system and resourcing constraints. As a result, there is considerable impetus across the industry to modernise the claims management process more broadly. Innovation in claims management systems is a developing area, and whilst it is early days, there is an increasing shift to online systems which enable claimants to lodge their claim and track its progress. This kind of innovation is expected to ultimately lead to a better member experience, reduce the time taken to assess claims, provide

support to the claimant to return to work through early intervention and rehabilitation mechanisms, enhance data collection processes, increase claims management capabilities within the industry and ultimately assist in improving the claims experience at the scheme.

Some emerging trends were also highlighted during the thematic review, including the increasing level of involvement by the legal profession in claims management processes, increased consideration of time limitations on a member's ability to claim, and greater emphasis on rehabilitation and retraining programs in an effort to return claimants to work.

*Good practices:*

- *Being aware of, and fulfilling, responsibilities to oversee the claims management process.*
- *Ensuring that the IMF clearly outlines the governance and documentation arrangements for claims management.*
- *Pursuing appropriate innovations in claims management practices, to deliver better member outcomes.*

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INSIGHT ISSUE ONE 2015

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## **INSURANCE IN SUPERANNUATION THEMATIC REVIEW**

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### **Conclusion**

Overall, the superannuation industry has made substantial progress in addressing the new prudential requirements and improving the sustainability of insurance arrangements. Nevertheless, APRA's thematic review has highlighted that further work needs to be undertaken by many RSE licensees to improve practices across a number of areas.

Whilst there are some signs of improvement in the group risk insurance market, it is expected to take a few years before it is clear whether the actions being taken by both the superannuation and life insurance industries are sufficient to achieve sustainable insurance arrangements in terms of premium levels, insurer profitability and insurance benefit design. APRA supervisors will be continuing to engage with the superannuation and life insurance industries to encourage RSE licensees, insurers and reinsurers to work together towards that objective.

