



11 August 2017

**TO: ALL RSE LICENSEES**

**STRENGTHENING OPERATIONAL GOVERNANCE OF RSE LICENSEES – UPCOMING CONSULTATION**

During 2012-2013, APRA introduced a new suite of prudential standards applying to the superannuation industry. APRA's supervision of RSE licensees over the four years since the prudential standards were introduced has identified areas where the prudential framework could be enhanced to lift operational governance practices.

The term 'operational governance' relates to how an RSE licensee determines its strategic objectives, undertakes business planning and runs its business operations on a day-to-day basis. RSE licensees are expected to govern their businesses in a manner that has at its core the long-term sustainability of their business operations, and the delivery of quality, value for money outcomes for beneficiaries.

While many RSE licensees have embedded sound operational governance practices throughout their business operations, APRA's supervision continues to identify weaknesses in the practices of some RSE licensees. These include:

- strategic and business planning processes that are based on unrealistic assumptions and lack adequate rigour, including use of poorly constructed indicators or key performance metrics;
- business initiatives where the link to the delivery of quality, value for money outcomes for beneficiaries appears limited or is not adequately demonstrated; and
- insufficient rigour around RSE licensee decision-making and monitoring in relation to fund expenditure, setting of fees and costs and the use of reserves.

APRA considers that enhancements to the prudential framework for superannuation will assist to address such weaknesses, and hence support RSE licensees in meeting the operational covenants in s. 52(2) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act). APRA therefore intends to consult on proposed changes to the superannuation prudential framework to strengthen operational governance practices of RSE licensees, reflecting evolving industry better practice and public expectations for the prudent and efficient operation of funds.

This letter outlines the key components of the proposed changes. APRA intends to implement these via changes to prudential standards and guidance that will be the subject of further consultation in due course.

Over 2017-18, APRA also intends to undertake a post-implementation review of all prudential and reporting standards and guidance for superannuation. Further detail on this review, which may lead to additional consultation on changes to prudential and reporting standards and guidance at a later date, will be provided in the coming months.

### **Operational governance, strategic and business planning and member outcomes**

Since 2012, key duties of RSE licensees, and of their directors, have been codified in some detail in the covenants in ss. 52 and 52A of the SIS Act. These enhanced obligations include a more precise set of requirements relating to conflicts of interest, including specifying that RSE licensees and their directors must act with the care, skill and diligence of a prudent superannuation trustee.

The governance framework for how RSE licensees and directors comply with these duties underpins the quality of the decisions made when running the RSE licensee's business operations. An operational governance framework encompasses the policies and processes that support RSE licensees' strategic and business planning, and ensure rigour in operational decisions, particularly those related to expenditure and reserving. It also includes how the delivery of strategic objectives and business plans is executed, reviewed and regularly monitored.

The superannuation prudential framework currently includes requirements in relation to investment and insurance governance frameworks, but there is a gap in relation to these core operational governance aspects. APRA therefore intends to consult on a proposal that an RSE licensee be required to have an operational governance framework. This requirement will reflect the policies and processes that a well-run RSE licensee should already have in place for its business operations, including sound strategic and business planning processes, and measures to ensure rigour in decision-making regarding expenditure and reserving.

#### ***Strategic and business planning***

Sound strategic and business planning, with appropriate monitoring against those plans, is essential for the effective management and oversight of all organisations. The increasing focus on the efficiency and competitiveness of the superannuation system means that sound strategic and business planning is even more crucial for RSE licensees, to effectively respond to emerging trends and challenges as the industry continues to evolve. Sound strategic and business planning is also critical to the ability of an RSE licensee to meet its obligation to act in the best interests of beneficiaries over the long term through delivery of quality, value for money outcomes.

To this end, APRA intends to consult on a proposal that RSE licensees have policies and procedures to establish, implement, monitor and review their business plan, and the achievement of strategic objectives.

#### ***Fund expenditure and reserving***

APRA continues to observe instances of poor governance practices by some RSE licensees in relation to decisions regarding the use of member money and fund expenditure, particularly where payments are made to related parties. The combination of poor processes and oversight, and failure to take action when issues are identified, can lead to inappropriate costs being incurred that ultimately negatively affect outcomes for beneficiaries.

Accordingly, APRA intends to consult on a proposed requirements for RSE licensees to meet minimum expectations when making decisions which require the use of fund assets, whether these decisions relate to expenditure incurred in running the fund, setting aside money in reserves or the setting of fees and costs policies to fund these decisions. These minimum expectations will include implementing appropriate policies and procedures to ensure there is adequate rigour in decision-making, monitoring and transparency related to the use of members' money.

As noted in the letter to RSE licensees on 25 July 2017, APRA also proposes to amend the reporting collection to support greater accountability and transparency on RSE licensee expenditure in light of the Government's proposed reforms to allow APRA to collect more expense data on a look-through basis.

### ***MySuper outcomes assessment***

The Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017 (the Bill) proposes to expand the existing scale test in s. 29VN of the SIS Act to require trustees to determine in writing, on an annual basis, whether the financial interests of the fund's beneficiaries who hold a MySuper product are being promoted on a basis that goes beyond the number of beneficiaries or total assets of the fund.

As noted in the 25 July letter, APRA is considering changes to the prudential framework to support RSE licensees' compliance with this legislative obligation, including issuing prudential guidance.

### ***Assessing outcomes for all beneficiaries***

APRA has long recommended that RSE licensees adopt a broad 'member outcomes' perspective in assessing the outcomes of their business operations for all beneficiaries. Beneficiaries of all products provided by an RSE licensee, not just MySuper products, are entitled to have confidence that the RSE licensee is continuing to deliver quality, value for money outcomes in their best interests.

Assessing member outcomes forms part of sound operational governance practices, and so appropriately fits with the proposed broader prudential framework changes outlined above. The conclusions that an RSE licensee may draw from an assessment of member outcomes should be a fundamental input into a robust strategic and business planning process.

To this end, APRA intends to consult on a proposal to require all RSE licensees to regularly assess whether the RSE licensee has provided, and is likely to continue to provide, quality, value for money outcomes for beneficiaries in all of its RSEs and products. The proposed assessment would include consideration of net investment returns, expenses and costs, insurance, and other benefits and services provided.

Where, as part of undertaking the assessment process, an RSE licensee identifies factors that are inhibiting it delivering appropriate quality, value for money outcomes for beneficiaries, the RSE licensee would be required to put in place specific actions to address these factors.

### **Next steps**

APRA welcomes feedback from RSE licensees and other interested stakeholders on the proposals set out in this letter, and requests that any feedback is provided by 11 September to [superannuation.policy@apra.gov.au](mailto:superannuation.policy@apra.gov.au).

APRA will also be holding roundtable discussions on the proposals outlined in this letter on 23 August 2017 in Melbourne and 31 August 2017 in Sydney. If you would like to attend one of these sessions please email [superannuation.policy@apra.gov.au](mailto:superannuation.policy@apra.gov.au).

Following consideration of feedback received on the initial proposals outlined in this letter, APRA intends to release a detailed package, including draft prudential standards and guidance, for formal consultation in late 2017.

Yours sincerely,

A handwritten signature in black ink that reads "Helen Rowell". The signature is written in a cursive, flowing style.

Helen Rowell

Deputy Chairman