8 November 2022

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

Dear Sir/Madam

Discussion Paper: Strategic planning and member outcomes: Proposed enhancements

The Actuaries Institute ("the Institute") welcomes the opportunity to comment on the issues raised in the Strategic planning and member outcomes: Proposed enhancements Discussion paper – dated August 2022 ("Discussion Paper"). The Institute is the peak professional body for actuaries in Australia. Our members have had significant involvement in the development and management of superannuation within Australia.

The introduction of superannuation prudential standard SPS 515 Strategic Planning and Member Outcomes ("SPS 515") and associated guidance in 2019-2020 has increased trustee focus on member outcomes. It has also raised the bar for business planning, which had not been to a uniform high standard across the superannuation industry.

The Discussion Paper outlines how APRA is looking to evolve SPS 515 and the associated guidance, given APRA's intention that the revised SPS 515 anchors the superannuation prudential framework. The Institute supports the intent of APRA's uplift to SPS 515 and sets out in the Attachment to this submission our responses to several of the questions raised in the Discussion Paper. In summary:

- We recognise the difficulty of structuring SPS 515 within the constraints of the annual member outcomes assessment framework in section 52 of the Superannuation Industry (Supervision) Act ("SIS Act"). The SIS Act framework requires an "all or nothing" determination as to whether the trustee's product is promoting the financial interests of the beneficiaries of the fund, is not cohort specific, and requires comparisons in areas like investment risk where it is unclear how this assists assessment unless combined with other characteristics to define the comparable universe of products. The Institute believes APRA's uplift to SPS 515 would be enhanced were it to work with Treasury and suggest some accompanying legislative changes to the SIS Act annual outcomes assessment.
- APRA has been supervising trustees' adoption of SPS 515, and so should be well placed to enhance the guidance provided to trustees and promulgate good practice by including examples of the better trustee practices it has observed.

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- SPS 515 only explicitly requires cohorting in connection with the trustee's Business Performance Review ("BPR"). APRA suggests more granular cohorting of members in the Discussion Paper to enhance consideration of member outcomes, as averages can hide a wide range of member situations and hence outcomes. The Institute supports the use of cohorting in SPS 515 to assess member outcomes, and suggests the standard itself is adjusted accordingly. This member outcomes cohort assessment will then be a valuable input to the strategic planning process. However, we caution against granularity without purpose, and where cohorting is used to assess member outcomes it should be principles-based and not be applied in a prescriptive manner.
- Member outcomes are considered throughout SPS 515 through a peer relative lens. Peer relativity is not always the most effective way of considering member outcomes as this ignores adequacy of potential outcomes.
- We suggest that SPS 515, SPG 516 and the fee principles should be enhanced to include the treatment of insurance administration costs, the setting of insurance administration fees/premium loadings and the treatment of tax deductions on insurance premiums.

The Institute looks forward to APRA's release of draft enhancements to the SPS 515 framework in early 2023 and would be pleased to discuss this submission.

Yours sincerely,

President

Attachment: Responses to selected APRA's consultation questions

1 Which, if any, provisions in the SPS 515 framework have worked well in improving business planning? Which, if any, provisions have caused unintended consequences? Please provide details.

SPS 515 has succeeded in formalising practices that improve the management and governance of superannuation funds. Whilst some trustees had adopted rigorous business planning prior to the introduction of SPS 515, SPS 515 has led to a significant uplift across the industry as a whole. APRA should be commended for this.

Provisions of the SPS 515 framework which have improved business planning include:

- Ensuring that the Business Plan includes key performance indicators which must be monitored;
- Ensuring that the Business Plan contains financial projections to inform the future outlook of the fund; and
- Ensuring comparative analysis forms part of the business planning framework.

Provisions of the SPS 515 framework which have caused unintended consequences include:

- Integration with the SIS Act Annual Outcomes Assessment legislation, given that the SIS Act assessment:
    - Requires an "all or nothing" determination as to whether a trustee's product is promoting the financial interests of the beneficiaries of the fund.
    - Is product focused, yet the Business Plan considers the trustee's operations as a whole.
    - Results are published in February-March each year in accordance with APRA guidance, and relate to the prior 30 June. This timing creates lags when used for a trustee's strategic planning.
    - Requires some comparisons which are difficult to interpret; e.g.
        - In areas like investment risk where it is unclear how this assists assessment unless combined with other characteristics to define the comparable universe of products. The prescribed use of the Standard Risk Measure is problematic because it is dependent upon the assumptions used and is often not reasonably comparable between superannuation funds. Ultimately long-term risk is more important to members' retirement outcomes and the Actuaries Institute has long proposed that such a measure be introduced.
        - Assessment of options, benefits and facilities provided (which are generally not product specific) without an overlay of the cost of providing these services.

The Institute suggests APRA's uplift to SPS 515 would be enhanced were APRA to work with Treasury so that the new version is accompanied by legislative changes to the SIS Act.

- APRA Heatmaps being introduced after the release of the SPS 515 framework, and hence APRA's lens on fund scale and sustainability is not effectively integrated into SPS 515, creating additional complexity for trustees.
- Difficulty in navigating SPS 515 in conjunction with other regulatory standards and guidance, where more explicit links would assist trustees if SPS 515 is to be the anchor for the superannuation prudential framework in relation to member outcomes. For example:
    - SPG 516 could include explicit guidance of how a trustee might avoid duplication and use analysis conducted for other prudential standards (e.g. SPS 250 and SPS 530) when conducting the BPR;
    - SPG 250 includes guidance covering the insurance aspects of member outcomes and refers to SPS 515;
    - Uplifts to other prudential standards (e.g. SPS 530) that have yet to be reflected in SPS 515; and
    - Explicit integration with ASIC's Design and Distribution Obligations, albeit that they do not apply to MySuper products.

2 Has APRA correctly identified the areas for enhancement? What additional areas could benefit from enhanced requirements or guidance to support effective strategic planning and delivery of outcomes to members?

Areas which could benefit from enhanced requirements or guidance include:

- Assessment of scale – further guidance could be provided on how funds should assess this to provide clearer linkage between scale (which is not necessarily always correlated with funds under management) and the actual member outcomes being provided for the given period.
- The purpose of cohorting – refer to question 3.
- Inclusion of sustainability metrics - particularly given APRA has already defined and produced these in various publications, such as the Heatmaps.
- Financial projections – refer to question 8.
- Assessment of member outcomes more broadly than through a lens of peer product relativity. Peer relativity is not always the most effective way of considering member outcomes as this ignores adequacy of potential outcomes. We suggest consideration of a forward looking (projected) member outcome measure that brings the impacts of various factors including investment returns, fees and insurance premiums charged into one. This would be in addition to the existing backward looking (historical/factual) measures. This can be done at a cohort level by considering the outcomes of a "typical member" within each cohort.

3 What additional guidance could be provided to help inform the development of cohorts?

In the Discussion Paper, APRA suggests more granular cohorting of members to enhance consideration of member outcomes. The Institute supports cohorting, as averages hide a wide range of member situations and hence outcomes.

The Institute suggests that APRA consider the following to help inform the development of meaningful cohorts.

Cohorting for member outcomes not business performance

Under SPS 515, cohorting is only explicitly mentioned in connection with the BPR. There is no formal requirement in SPS 515 to consider different cohorts of beneficiaries when considering annual outcomes assessments.

Even within the SPS 515 BPR requirement, cohort analysis is not given a purpose or objective and so it is not clear to a trustee why it is looking at outcomes for different cohorts and, therefore, how it selects cohorts or determines what to do with the results. For example, in most cases a trustee's strategic objectives apply across all membership cohorts.

We therefore recommend that APRA gives greater consideration to how cohorts should be used within SPS 515. We recommend that cohorting remains principles-based and not be applied in a prescriptive manner, and is only required where outcomes differ by cohort (e.g. fees vary by account balance, so cohorting by account balance provides important insight). A suggestion is that SPS 515 could include a requirement for a trustee to describe how it decided to choose particular cohorts.

Purpose statement

SPS 515 should include a formal purpose and objective of cohort analysis. For example:

"*The purpose of cohort analysis is to:*

- *Identify cohorts of members who may achieve outcomes outside a reasonable range from the average member; and*
- *As a result, make appropriate modifications (e.g. to product designs, price/fee structures and/or member services) to either improve member outcomes for these members, or encourage the members to consider an alternative product*".

Consolidated principles-based guidance

Where guidance on cohorts is provided under the existing strategic planning and member outcomes framework, it relates to member outcomes, is limited and split between different SPGs (e.g. SPG 516 and SPG 250) rather than consolidated to make it easier for trustees to navigate and interpret. The current array of cohort examples should be consolidated into a single section within SPG 516.

Further, existing guidance does not include guidance on the thought process on how to select appropriate cohorts. We suggest SPG 516 be enhanced to explain the process for trustees to determine appropriate cohorts. This could reflect the importance of understanding the characteristics of the particular fund and, from that, determining and examining cohorts within which member outcomes differ markedly from the norm for the fund overall so that they may lead to sub-optimal member outcomes.

More specific examples

SPG 516 could be enhanced to provide examples of a fund with particular characteristics and a possible choice of cohorts that reflects those characteristics, as opposed to "general" examples that might apply irrespective of the fund characteristics. APRA has been supervising trustees' adoption of SPS 515, and so should be well placed to enhance the guidance provided to trustees and promulgate good practice by including examples of the better trustee practices it has observed.

For example:

"Fund A is a multi-industry, nationwide fund with demographics broadly reflecting the Australian working (accumulation) and retired (pension) population. Within that overall demographic, it has a significant number of members in the 25 to 35 age range who are on low incomes and take career breaks to raise children. As a result, the trustee of Fund A decides to adopt this as a particular cohort for analysis (amongst its overall group of cohorts).

In considering member outcomes, the trustee takes into account the results of member surveys and population statistics to build a picture of the typical characteristics of this cohort. For example, when assessing insurance cover, the member outcomes assessment for this cohort considers the insurance benefits relative to insurance needs in the event of a claim and the ultimate retirement benefit reflecting insurance premiums paid. It assesses the trade-off between insurance benefits and retirement outcomes for this cohort. It then determines whether that trade-off is appropriate and, if not, what changes to the insurance arrangements should be made. It also considers whether the insurance fees for members in this cohort are equitable compared to other cohorts and the membership overall".

Define "member outcomes"

We believe member outcomes are personal and the ultimate goal should be to achieve personalisation with a cohort of one. We suggest the ultimate member outcome from superannuation is to maximise the projected retirement income a member receives, taking account of the accessibility and risk objectives included within the Retirement Income Covenant.

To assist, SPS 515 should not only focus on peer relative outcomes but also consider the sum of a member's interests in a fund (i.e. be at a member not product level). For example, if members at different ages are considered as cohorts, then a trustee may decide to consider outcomes of:

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

At the same time, an analysis of individual member behaviour rather than at the cohort level may indicate that some members are experiencing worse outcomes than anticipated, through actions not identified as part of cohort analysis. This could include the impact of:

- Switching to cash during market volatility and remaining there for a long time until retirement; and/or
- Materially lower net return for the period, for example compared to a default member or after allowing for proxies.

Including this type of individual member assessment would allow a trustee to identify and mitigate the impacts of any detrimental activity or outcome (while complying with the requirements of superannuation and financial advice legislation).

4 What challenges, if any, has industry faced in developing cohorts of members for the purposes of the retirement income strategy?

A key challenge is the lack of member data other than the superannuation account they have with their fund. Superannuation funds do not have data about the holistic household financial situation to provide the best help they can in delivering retirement solutions including appropriate Age Pension estimates. Trustees also need to know whether the member has any other superannuation account with a different fund to obtain the total superannuation asset members have, to help them with their retirement planning.

The Institute has consistently urged APRA and other regulators and the government to improve the flow of relevant data to trustees, for example through employers and the ATO. The planned roll out of the Consumer Data Right (CDR) could be a step forward in making this data available with member consent.

5 To what degree would taking the above approach to financial management, including adoption of performance measures, monitoring and stress testing, differ from current practices? How might such obligations be implemented without undue regulatory burden?

The holistic financial management of superannuation funds, and measurable financial management measures, are important for the reasons outlined by APRA.

A superannuation fund's financial resources should be sufficient to both achieve the strategic objectives set out in the business plan, and also to manage risk. A Board will typically define its key risks within its risk management framework and the financial resources required should be set consistently. All risks need to be considered, not only operational risks. We refer to the Actuaries Institute Research Paper entitled "Uplifting Superannuation Risk-Based Capital Management" dated April 2022.

We suggest that completing financial projections, and in particular stress testing of the financial projections based on alternative scenarios and assumptions, should be a key component of the management of a superannuation fund's financial resources. Please refer to our response to question 8 for further comments on financial projections.

8 How does the Board currently satisfy itself that a robust financial projections methodology underpins the business plan? How does the Board intend to develop its use of financial projections (and assumptions underpinning them) presented in the business plan?

The role of the Board should be to focus on implications of the financial projections presented and whether any changes are required, particularly if the sustainability outlook is poor.

Accordingly, we suggest that SPS 515 be updated to require the Board to ensure that the financial projections are prepared consistently with appropriate professional expertise. For example, the financial projections methodology and assumptions underpinning the projections could be signed off by an appropriate independent professional and supported by professional standards and guidance as required. The benefits of involving professional expertise would include:

- Robust experience process to arrive at appropriate methodology and assumptions, with justification on a consistent basis;
- Appropriate scenario and stress testing with consideration of the key assumptions and how they are adjusted;
- Consistent financial projection methodology and process across the industry; and
- Robust governance using a control cycle to update the financial projections on a regular basis.

Many superannuation funds are large and the demographic drivers of the sustainability of the superannuation fund can take years to materially impact member outcomes. This also means that Boards need to act early to implement some changes. We suggest that superannuation funds should be completing financial projections for periods longer than three years.

9 What additional fee setting principles should be reflected in the SPS 515 framework?

We support APRA's intention to amend SPS 515 so that it requires that trustees demonstrate how they have set fees in a manner that is consistent with the fee principles set out in the November 2021 Discussion Paper "Strengthening Financial Resilience in Superannuation".

However, neither the current Standards, prudential guidance, the fee principles nor the Discussion Paper mention insurance in this context. We believe this is an important omission. Against this background, we suggest that SPS 515, SPG 516 and the fee principles should be enhanced to include the treatment of insurance administration costs, the setting of insurance administration fees/premium loadings and the treatment of tax deductions on insurance premiums.

12 What additional benchmarks do RSE licensees consider when assessing performance? In determining an overall assessment of outcomes, how are the various benchmarks weighted?

Additional benchmarks to assess performance

We have observed trustees use the following additional benchmarks when assessing performance:

- Investment returns relative to the CPI+ objectives set out in the Investment Governance Framework and outlined in the Product Disclosure Statement;
- Metrics included in rating house dashboards and surveys (e.g. those provided by Chant West and SuperRatings);
- Net Promoter Score improvement; and
- Projected retirement income of members relative to published metrics such as ASFA and/or Super Consumers Australia.

Some of these metrics assist with benchmarking comparable performance. Others focus on benchmarking improved outcomes for members and are useful in assessing whether overall member outcomes are improving year on year.

Weighting benchmarks

SPS 515 paragraph 21 requires a trustee to document how it has balanced the items required under the Annual Outcomes Assessment to arrive at the overall determination. There is no explicit requirement to use weightings when balancing the items. Regardless of the approach to balancing the required items, virtually all products have been determined to have promoted members' interests.

Most published outcomes assessments do not provide details of whether weightings have been applied by trustees, or whether the approach to balancing the required items has changed year on year. Beyond SIS Act section 52 (12) requiring a trustee to, in particular, consider returns to its beneficiaries (after the deduction of fees, costs and tax) we are unaware of the approaches being taken across the industry.

Indeed, we believe member outcomes are likely to be enhanced by avoiding specific weightings for each of the various components involved in the outcomes assessment given the main power of the assessment should be to improve member outcomes overall. A weighting could result in trustees accepting an overall "pass" when there are several pockets of underperformance across a product's features.

13 What additional areas of data would be useful in developing comparable assessments of performance?

APRA has rightly referred to its Superannuation Data Transformation project, designed to increase the depth and breadth of data collected and its intention to clarify the expectation that trustees will leverage this additional and more granular data to support enhancements in their assessment of outcomes.

However, we caution APRA against prescribing ever more granular assessment of comparable performance as outcomes at a member level depend more on the choices made by members amongst the suite of product features, rather than the relative performance of a particular product feature.

APRA's Superannuation Data Transformation project continues to improve the availability of data that can be used by trustees for comparable assessments of performance. Additional areas of data that might be useful include:

- Data at member level rather than account level to allow improved member outcomes assessments;
- Accumulation and pension phase data including assets and membership by age and gender rather than the current taxed and untaxed data split;
- Drawdown rates of account-based pensions by age and account balance to improve the assessment of retirement income strategies;
- Data that allows more in-depth comparison of insurance offerings; and
- Data that assists with comparison of member services.

Additional data collection by APRA and reporting back to trustees will not overcome the lack of appropriate data held by trustees in the first place. In particular, we urge APRA to work with Treasury and the ATO to facilitate the provision of the following additional data fields to trustees in order to enable trustees to undertake more granular cohort analysis where they believe this is necessary:

- Occupation, household income and spouse status collected from the ATO as part of the member's annual tax return; and
- ANZSIC Code of the member collected via the Single Touch Payroll as a new data field.