



AUSTRALIAN INSTITUTE of
SUPERANNUATION TRUSTEES

11 September 2017

By email

Email: superannuation.policy@apra.gov.au

Dear Sir/Madam,

Re: Strengthening operational governance of RSE licensees

In brief:

AIST supports the member outcomes test proposed for all superannuation products provided the role of net returns are not diluted. AIST also submits that the existing regulatory framework provides APRA with sufficient power to address governance weaknesses.

AIST thanks the Australian Prudential Regulation Authority (APRA) for the opportunity to comment on the proposals set out in [APRA's letter to RSE licensees](#) dated 11 August 2017. Our main concerns are as follows:

- **Different approach needed:** APRA should consider dividing the consultation into two separate processes: one relating to the outcomes assessment for MySuper and other products and one relating to the proposed prudential standards on operational governance and a review of the standards. The two processes address different issues and combining them in one consultation processes is confusing.
- **On the outcomes assessment test:** AIST supports applying an outcomes assessment to all products, not just MySuper products. However, APRA's and the Government's current approach to the outcomes assessment dilutes the role of net investment returns, and APRA's current review should be based on existing legislative requirements and the focus should be on promoting optimal long-term net returns.
- **Existing prudential standards effectively establish an operational governance framework:** APRA should conduct a review of existing superannuation prudential standards to determine whether the existing provisions effectively require superannuation funds to have an operational governance framework in place.
- **Existing oversight mechanisms on business planning are sufficient:** Strategic and business planning oversight mechanisms are already in place and we invite APRA to explain why these mechanisms are inadequate or require extension.
- **APRA's current powers are sufficient to address governance weaknesses:** This submission raises questions about the need to extend APRA's powers to address governance weaknesses. We ask APRA to specify the areas where the existing regulatory framework is insufficient.

- **Fund expenditure and APRA's approach to business planning:** While fund expenditure must involve the appropriate use of trust money, this is best looked at from the perspective of strategic and business planning. Rather than focusing on the point of expenditure, AIST recommends that APRA review *SPS 220–Risk Management* and its consequent approach to strategic and business planning.

APRA's approach to the consultations:

Greater clarity is needed

We believe that greater clarity is required to adequately assess:

- The rationale for developing an operational governance framework.
- The basis of a members' outcomes assessment.
- APRA's proposed enhanced powers.

Since the Government released the public consultation draft of the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017*, APRA has released three related letters to RSE Licensees:

- 25 July 2017: [Consequential amendments to APRA's prudential framework](#).
- 11 August 2017: [Strengthening operational governance of RSE licensees](#).
- 31 August 2017: [Assessing member outcomes in the superannuation industry](#).

While this submission is specifically in response to the 11 August letter, the interplay between the documents means that there is confusion about the basis upon which a strengthened operational governance framework and a member outcomes assessment would apply.

It is also unclear to what extent (if any) the outcomes assessment process flagged in the 31 August 2017 letter is dependent on the passage of the outcomes assessment component of the Bill. If the assessment does not require the legislation to be passed, AIST questions the need for a legislated outcomes assessment and the enhanced powers for APRA.

An alternative approach to the consultation process should be considered

APRA should consider adopting a different approach to this consultation process in order to ensure that all issues can be dealt with effectively and to avoid unintended consequences that may stem from a confusing process. The consultation should be split into two separate streams:

- Stream 1: Consideration of an outcomes assessment for both MySuper and other products.
- Stream 2: The review of the prudential standards and the consultation on the proposed operational governance requirements should be dealt with together.

Outcomes assessment:

The consideration of an outcomes assessment for both MySuper and other products should be dealt with separately and should not be combined with the operational governance and prudential standards consultation. The outcomes assessment consultation should have a separate timetable developed after the outcomes of *the Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017* is known. A copy of AIST's submission on the draft Bill is attached.

In the event that the Bill is amended APRA will need to reconsider its position on these issues.

AIST agrees with consultation on the proposed enhancements at an early stage, and suggest that this be an ongoing part of APRA's consultative arrangements.

APRA should also develop a program of work around the outcomes assessment component of these changes following the passage of any new accountability legislation. In the event of the outcomes assessment legislation not passing or being substantially amended, APRA should clarify its intentions in relation to assessing outcomes for all members.

Prudential standards and operational governance:

One of the objectives of this consultation process is for participants to provide practical suggestions about efficient ways to strengthen operational governance while not unnecessarily adding to the compliance burdens on funds. We believe the questions about strengthening operational governance should be incorporated into a review of the existing superannuation prudential standards; it is logical for these two processes to be combined.

While we acknowledge that the prudential measures would be supported by the proposed legislation, through the increased reporting and transparency of expenditure, we note that the operational governance measures are not dependent on the proposed legislation.

AIST also agrees that APRA's superannuation prudential standards should be reviewed periodically. Prior to implementation of the superannuation prudential standards APRA, in a 2012 Regulation Impact Statement,¹ anticipated reviewing the effectiveness and appropriateness of the standards 3 to 4 years after they commenced. AIST submits that there should have been a review within four years of their commencement, and that formal four yearly review processes should now be put in place.

¹ Australian Prudential Regulation Authority (2012). *Regulation Impact Statement*. [online] Available at: <http://tinyurl.com/yazhx47n> [Accessed 5 Sep. 2017].

However, APRA's decision to undertake a *separate* post-implementation review of all prudential and reporting standards and guidance with "additional consultation... at a later date", should be reconsidered.

AIST's view is that the process to review prudential standards should be in tandem with the strengthening of operational governance of super funds. It would be more effective and efficient to include the identification of areas where prudential standards should be enhanced to lift operational governance practices in the one exercise.

AIST recommends that the prudential standards review process should include a stated objective of reducing, or at least not increasing, the overall regulatory burden on APRA-regulated super funds. The regulatory burden can be reduced by rationalising and streamlining existing standards and guidance, assessing if any existing requirements are no longer necessary, and incorporating strengthened operational governance requirements within existing standards (for example, in an expanded *SPS 220–Risk Management*).

This approach would be consistent with the Government's Statement of expectations for APRA², particularly the expectation that APRA will achieve its objectives more efficiently and reduce the overall regulatory burden.

Without this objective, and looking at the totality of the proposals made by APRA, it appears that a large number of additional regulatory tasks are being overlaid on super funds, including the overwhelmingly majority of high-performing profit-to-member funds.

Outcomes assessment:

Assessing outcomes for MySuper beneficiaries

AIST made the attached submission to the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017*. As APRA is aware, AIST is concerned that the Government's proposed outcomes assessment in its current form risks diluting the role of net investment returns in delivering optimal retirement outcomes for superannuation fund members. AIST has recommended a two-tiered process that gives net returns precedence over other criteria, such as services provided and facilities offered.

AIST submits that changes to the prudential framework to support funds' compliance with this legislative obligation should await the outcome of the parliamentary processes.

² Australian Prudential Regulation Authority (2017). *Statement of Expectations*. [online] Available at: <http://tinyurl.com/y76qakzo> [Accessed 5 Sep. 2017].

Assessing outcomes for all beneficiaries

AIST supports a broad member outcome perspective in assessing the outcome of business operations in relation to members of all products, not just MySuper products. In the 11 August letter, APRA notes that it has “long recommended” such an approach. AIST further supports this by pointing to the requirements in the prudential standards previously cited as evidence of APRA’s existing powers to ensure that all funds have this focus.

This is further underlined by the approach taken by APRA in their 31 August letter where APRA advise its current outcomes assessment process. However, AIST calls on APRA to specifically demonstrate how their current process involves the application of the currently legislated scale test. Funds with MySuper products are currently required to assess the long-term net performance of their MySuper products with other MySuper products. Under the current legislation, the assessment should be based on this approach, and AIST seeks that APRA provides confirmation about this.

Operational governance, strategic and business planning and member outcomes:

The APRA letter foreshadows a requirement for super funds to have an operational governance framework that sits alongside the fund’s investment and insurance governance frameworks. AIST recommends that APRA conduct a review of existing superannuation prudential standards (SPS) to determine whether the existing provisions effectively require superannuation funds to have an operational governance framework in place.

The APRA letter does not refer to the requirements in *SPS 220 – Risk Management* for a fund to have risk management framework. AIST recommends that, as a first step, APRA investigate the extent to which the existing provisions of *SPS 220 - Risk Management* can be used to address identified weaknesses in the operational governance of some funds. In the event that APRA identifies gaps in the prudential standard, it is recommended that APRA consults with industry about the options to fill these gaps that may include changes to *SPS 220 – Risk Management* and associated guidance.

It is noted that SPS 220 already contains requirements that address operational governance and business planning, such as the requirement to “*have a written business plan that sets out the high-level strategic direction on the RSE licensee’s approach to managing its business operations*”.

SPS 114 – Operational Risk Financial Requirement, *SPS 231 – Outsourcing* and *SPS 232 – Business Continuity Management* are also directly relevant to managing operational governance and business planning, and should be included in the overall review of prudential standards that AIST recommends.

Strategic and business planning:

While AIST agrees with APRA's comments about the need for sound strategic and business planning with appropriate monitoring we believe that oversight mechanisms already exist. The mechanisms are already in place, and we call on APRA to explain why these are inadequate or require extension.

In the letter APRA states that it *"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"*.

Each element of this is already specifically addressed in SPS 220:

18. *An RSE licensee must have a written plan that sets out the strategic direction of the RSE licensee's approach to managing its business operations (business plan). The business plan must cover the entirety of the RSE licensee's business operations, be aligned with the risk management framework and be approved by the Board prior to its adoption and at any time that it is materially revised. The business plan must be a rolling plan of at least three, but no more than five, years' duration that is reviewed at least annually (or as close to annually as is practical), with the results of the review reported to the Board.*
19. *An RSE licensee's strategic and business planning process must:*
 - (a) *identify and consider those material risks associated with the RSE licensee's strategic objectives and business plan that are required to be explicitly addressed and managed through the risk management framework; and*
 - (b) *consider the material risks that have been identified by the risk management framework³.*

³ Australian Prudential Regulation Authority, *Prudential Standard SPS 220 Risk Management*, 5.

Additional APRA powers sufficient to address governance weaknesses:

APRA should consider whether their existing powers are adequate to address governance weaknesses. APRA should only consider extending their power if their extensive legislative powers are deficient.

The 11 August 2017 letter appears to support the proposition that APRA already holds sufficient legislative powers to address operational governance issues, including assessing member outcomes for all members (not just those with an interest in MySuper products).

AIST notes the operational governance weaknesses highlighted by APRA but submit that:

1. APRA already has sufficient powers to address governance weaknesses (except possibly early intervention powers). Table 1 below details APRA’s extensive powers.
2. APRA’s focus should be on the specific funds displaying these weaknesses.
3. The approach outlined by APRA will be a distraction and an additional compliance burden on funds with good operational governance.
4. Poor practices relating to related party providers identified in APRA’s 2010 report⁴ and the remediation of these issues should continue to be a priority for APRA.

Table 1: Outline of APRA’s powers to address governance weaknesses

APRA power	Detail of power
<i>Power to seek an injunction</i>	APRA has the power to seek an injunction to restrain persons from engaging in, or proposing to engage in, specified conduct outlined in the SIS Act. ⁵
<i>Suspend or remove a trustee</i>	APRA has the power to suspend or remove a trustee of a superannuation entity in circumstances, such as: ⁶ <ul style="list-style-type: none"> • It becoming apparent to APRA that conduct has been, is being, or proposed to be engaged in by the RSE licensee may result in the financial position of the entity or of any other

⁴ Australian Prudential Regulation Authority (2010). *Working Paper: Australian Superannuation Outsourcing - Fees, Related Parties and Concentrated Markets*. [online] Available at: <http://tinyurl.com/hkkmhken> [Accessed 5 Sep. 2017].

⁵ *Superannuation Industry (Supervision) Act 1993* s 315.

⁶ *Ibid* s 133.

	<p>superannuation entity becoming unsatisfactory.</p> <ul style="list-style-type: none"> • The RSE licensee breaching a RSE licence condition.
<i>Disqualification</i>	APRA has power to disqualify individuals that are, or were, responsible officers of trustees. ⁷
<i>Appointing acting trustee</i>	APRA can appoint an acting trustee on suspension or removal of a superannuation entity. ⁸
<i>Infringement notices</i>	APRA can issue infringement notices if it reasonably believes that a SIS Act provision has been contravened and the provision is subject to the infringement notice regime. ⁹
<i>Ongoing reviews of management and operation of entities</i>	APRA regularly reviews the management and operations of superannuation entities through reviewing various reports received by those entities under the law.
<i>Investigate</i>	<p>APRA can investigate an RSE licensee if it believes the financial position of the superannuation entity may be unsatisfactory.¹⁰</p> <p>APRA can also require the trustee to appoint an individual to investigate the whole or specified part of the financial position of the entity and make a report on this investigation.¹¹</p>
<i>Directions power</i>	APRA has the power to issue a direction to an RSE licensee if APRA has reasonable grounds to believe that the RSE has breached a condition of their licence. ¹² Licence conditions include a requirement for

⁷ Ibid s 126A (1) – (3).

⁸ Ibid s 314.

⁹ Ibid s 223A.

¹⁰ Ibid s 263 (1)(b).

¹¹ Ibid s 257 (1)(a)–(b).

¹² Ibid s 29EB (a)–(b)

	<p>the RSE licensee to comply with RSE licensee law, which includes the SIS Act, regulations, prudential standards and other legislation.¹³</p> <p>APRA can also issue directions about acquiring or disposing of assets, or a freezing of assets if the entity’s conduct is likely to adversely affect the interests of beneficiaries.¹⁴</p>
<i>Directions power – prudential standards</i>	<p>APRA can issue a direction to a RSE licensee if it has reasonable grounds to believe that the RSE licensee has not complied with prudential standards.¹⁵</p> <p>APRA has power, enshrined in legislation, to make prudential standards relating to prudential matters. Prudential matters are widely defined.¹⁶</p> <p>These powers effectively mean that APRA has a high degree of flexibility, and ability, to develop and enforce various requirements on RSE licensees.</p>
<i>Obligations on auditors and actuaries</i>	<p>There is a positive obligation on auditors and actuaries to inform the regulator in writing if any contraventions of the SIS legislation or the <i>Financial Sector (Collection of Data) Act 2001 (FSCDA)</i> may have occurred.¹⁷ This notification requirement ensures the regulator can act as soon as practicable if necessary.</p>
<i>Power to approve a RSE licence</i>	<p>APRA has the power to grant a RSE licence, provided specified criteria are met.¹⁸</p>
<i>Power to impose additional conditions on an RSE licensee</i>	<p>APRA has the power to impose additional conditions on RSE licensees, above minimum legislative conditions.¹⁹</p>

¹³ Ibid s 29E(1)(a); s 10(1).

¹⁴ Ibid s 264 (1) – (5).

¹⁵ Ibid s 29E(1)(a); s 10(1).

¹⁶ Ibid s 34C.

¹⁷ Ibid s 129(3).

¹⁸ Ibid s 29D.

¹⁹ Ibid s 29EA.

<p><i>Powers related to licensing of trustees</i></p>	<p>Part 2A of the SIS Act sets out APRA’s broad powers and responsibilities regarding the licensing of trustees and includes:</p> <ul style="list-style-type: none"> • Power to grant or refuse a RSE license.²⁰ • Power to impose additional conditions on RSE licensees at any time.²¹ • Power to vary or revoke licence conditions.²² • Power to cancel a RSE license.²³
<p><i>Powers related to RSEs</i></p>	<p>Part 2B of the SIS Act sets out APRA’s powers regarding the management of RSEs and includes the power to:</p> <ul style="list-style-type: none"> • Register or refuse to register an RSE.²⁴ • Cancel the registration of an RSE.²⁵
<p><i>Powers related to MySuper</i></p>	<p>Part 2C of the SIS Act sets out APRA’s powers related to MySuper products and includes the power to:</p> <ul style="list-style-type: none"> • Authorise or refuse authorisation for an RSE licensee to offer a MySuper product.²⁶ • Cancel a MySuper product authorisation.²⁷
<p><i>Power to declare superannuation funds as public offer funds</i></p>	<p>APRA has the power to declare superannuation funds as public offer funds.²⁸</p>

²⁰ Ibid s 29D; s 29DE.

²¹ Ibid s 29EA.

²² Ibid s 29FD.

²³ Ibid s 29G.

²⁴ Ibid s 29M.

²⁵ Ibid s 29N.

²⁶ Ibid s 29T; s 29TE.

²⁷ Ibid s 29U.

²⁸ Ibid s 18(6).

APRA's approach to fund expenditure and reserving:

AIST is concerned that APRA risks its objectivity and independence in its approach to the use of trust money and fund expenditure. At the Melbourne roadshow on operational governance on 23 August 2017, APRA cited the industry fund advertising campaign as an example that has been raised in the political process. Conflating of political questions and the conflict between different sectors in the superannuation industry with issues of poor governance does not seem to be useful or appropriate.

While fund expenditure must involve the appropriate use of trust money, this is best looked at from the perspective of strategic and business planning. It is much easier to manage expenditures at the earlier stage of business planning than later during the execution of the plan.

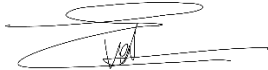
Rather than focus on the point of expenditure, AIST reiterates its recommendation that APRA review *SPS 220 – Risk Management* and its consequent approach to strategic and business planning. As part of their business planning, funds establish a framework in which budget decisions are made; this includes details of how and what budgetary and expenditure decisions can be made; controls put in place, how expenditure will be monitored and changed circumstances assessed. Notwithstanding the comments in the letter, these are existing obligations under SPS 220.

It is unclear what APRA's concerns are in relation to reserving or its proposed response, beyond the call for greater "rigor" in reserving decisions. The management of super fund reserves is already well regulated, with prudential practice guide 222 addressing the issue generally, and prudential standard SPS 114 specifically addressing operational risk financial requirements. PPG 222 includes numerous elements to be addressed in the management of reserves, and these require a high degree of rigor.

AIST recommends that APRA clarify its concerns and proposed approach in relation to the management of reserves. AIST also renews our call for a review of SPS 114 in order that super funds are able to develop an approach to the accumulation and management of their operational risk financial reserve that reflects the risk profile of their fund, and is in the best interests of members.

Please contact David Haynes, Senior Manager Policy on (03) 8677 3803 or at dhaynes@aist.asn.au should you wish to discuss our submission.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Eva Scheerlinck', is written over a light blue horizontal line.

Eva Scheerlinck
Chief Executive Officer

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the \$700 billion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.