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Ms Carolyn Morris  
Australian Prudential Regulation Authority  
GPO Box 9836  
SYDNEY NSW 2001

via e-mail to: [superannuation.policy@apra.gov.au](mailto:superannuation.policy@apra.gov.au)

Dear Ms Morris,

**Re: Consultation on APRA's superannuation operational governance proposals**

The Association of Superannuation Funds of Australia (ASFA) would like to lodge this submission in response to the consultation on APRA's proposals to *strengthen operational governance of RSE licensees*.

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through our service provider membership, represents over 90 per cent of the 14.8 million Australians with superannuation.

**General observation**

ASFA acknowledges that this preliminary consultation is the first stage in what may be a lengthy process and the following observations are intended to describe the broad direction we would prefer APRA to adopt as it works out the details for each proposal.

We also note that the proposals to strengthen operational governance are heavily reliant on the successful passage of the *Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017* (the Bill).

As we have said before, most recently in our response to the exposure draft of the Bill, the superannuation system requires a strong regulatory framework and regulators should have appropriate powers and instruments to ensure that the system is stable, efficient and delivers on its objectives. However the system is already subject to significant regulatory obligations and oversight and there must be a clear justification for any extension of those regulatory obligations.

In our previous response we recommended that a Regulation Impact Statement (RIS) be prepared to demonstrate due consideration of the impacts and costs of additional obligations on superannuation fund

operations and member outcomes and we recommend that a similar approach be adopted for these proposals. We note that APRA has previously prepared regulatory impact statements for major prudential reforms, including prior to the introduction of the suite of prudential standards for superannuation arising out of the Stronger Super reforms.

We recommend that APRA use existing superannuation fund processes and reporting data when determining the detail for the various proposals to strengthen operational governance. For example it would seem likely that the existing quarterly and annual fund reporting would provide much of the information APRA would need to make an independent assessment of a superannuation fund business plan. Indeed, APRA appears to be drawing significant conclusions from the existing data and is clearly performing its oversight function cognisant of this. The purpose of new data requirements should be clearly articulated by APRA.

We also think that care needs to be taken in the formulation of the outcomes test for all beneficiaries. It will necessarily be more complex than developing the test for MySuper given the variability in investment approaches, insurance, service provision and other product features. The test should be adapted in recognition of the circumstances of the individual fund and a prescriptive and standard approach should be avoided. There is a risk that the purpose of this outcomes test could be confused with that of the MySuper outcomes test and it is important that a clear conceptual separation be maintained between the two.

## General observations

As it prepares the detail for the operational governance framework proposals we suggest that APRA keep the following general principles/observations in mind:

1. The regulatory burden is already heavy for RSE licensees. The superannuation sector has recently been subjected to significant regulatory change, including the development of a substantive prudential framework.
2. The regulatory impact of these proposals should be kept to a minimum through the use of existing resources held by APRA. Careful, transparent consideration of the cost and impact of further regulation on fund members is necessary. This should occur via the issuance of a regulatory impact statement, prior to implementation of any proposal.
3. APRA should look to information gathered by other government agencies, specifically ASIC and the ATO, and use it where possible. Any new APRA reporting requirement should be made as consistent as possible with that already required by these agencies and in particular the reporting format should not vary.
4. The proposed operational governance framework cuts across many of the existing prudential standards. In line with our recommendation for duplication to be avoided, APRA should look to the existing standards first before issuing fresh guidance or review the existing standards as part of the planned prudential standard review to remove any overlap
5. A business plan can only be judged as a whole as its component parts are interdependent. Unexpected stress in one component can have an impact on one or more other components.
6. There are a range of exogenous factors that can impact whether a business plan is ultimately successful. The prudential regulator should focus on the adequacy of trustee's processes in developing and monitoring its plan.
7. Any assessment of the success of a business plan needs to be tailored to an RSE's particular features and circumstances
8. Quantitative assessment is much easier than qualitative and therefore can be more attractive to regulators. Given the importance of qualitative measures in the assessment of planning and 'member outcomes' it is important to pay due regard to both elements when assessing operational governance.
9. Timeframes will be an important factor in assessing outcomes. While the adequacy of governance processes can be more immediately and objectively determined, the same cannot be said of important outcomes such as investment returns. Forming conclusions on outcomes too soon is likely to detrimentally affect members and must be avoided in the assessment process.

## Specific comments

### 1. Requirement to develop an operational governance framework

It would appear that the crucial element of the proposed operational governance framework is the requirement to plan and in particular to develop a business plan, to establish 'sound strategic and business planning processes'. We note that the term 'operational' is somewhat ambiguous and we have interpreted it to mean 'whole-of-fund' or a view that brings together in one place all an RSE's business planning activities.

ASFA would like to raise the following issues with respect to the proposals:

#### *1.1. The regulatory framework is already rigorous*

Trustees already have significant obligations, fiduciary and others, and the regulatory environment in which they operate is already rigorous and demanding. As the prudential regulator APRA already has substantial powers, both direct and indirect.

APRA has on a number of occasions indicated that it has identified a number of weak or poorly performing superannuation fund trustees. We note APRA's letter to RSEs of 31 August 2017 which states that these funds will be approached and required to develop robust and implementable strategies to address any weaknesses or prepare for the transfer of members to another fund.

This suggests that APRA has the ability, using existing data, to identify and impose sanction upon those RSEs who do not meet the standards required. The need for additional reporting and planning obligations should be approached cautiously and clearly justified.

#### *1.2. The potential for duplication should be minimised*

The prudential standards already cover a lot of the territory that would fall under the definition of an operational governance framework and the associated business and strategic planning needed to support it, specifically: *SPS 114 Operational Risk Financial Requirement; SPS 220 Risk Management; SPS 231 Outsourcing; SPS 250 Insurance in Superannuation; SPS 510 Governance ; and SPS 530 Investment Governance.*

For example, there are already significant business plan requirements in SPS 220 and many of the other monitoring and evaluation requirements feature in the other prudential standards.

ASFA recommends that as APRA works to determine the requirements for the operational governance framework and associated planning that it take account of the existing requirements and obligations and avoid imposing duplicated reporting or other obligations. Alternatively APRA should also consider this as it undertakes the planned review of the prudential standards and their effectiveness to ensure that any duplication which may emerge be removed.

#### *1.3. APRA's Operational Governance Framework requirements*

ASFA advocates that any business plan requirements APRA may set should be principles-based and relate to a fund's strategic or high level aims. APRA should not become involved in setting a fund's internal measures or KPIs. APRA should set appropriate guidelines and within reason leave the detail to superannuation fund trustees.

#### *1.4. Flexibility*

As already stated the regulatory impact of any reform should be minimised and information drawn from existing resources and reporting where possible. In line with this the business plan content, format and other requirements should not be prescriptive or differ significantly from the industry standard or a business plan which any well-run RSE produces now.

Beyond setting some principles-based minimum requirements, existing planning processes should be allowed to continue where they exist. There is considerable variety in the operations of superannuation funds and we also support an approach where business plans can be tailored to the circumstances of individual funds rather than a strict, prescriptive and standardised approach.

#### *1.5. Business plan should be judged as a whole*

Our members have made the comment that while business plans will have components, sub-components, and performance measures and targets relating to those components the business plan can only be judged properly by looking at it overall as the components interact with each other. Good judgment is as important as good information in evaluating the success of a business plan.

For example, significant regulatory reform may require an RSE to reallocate resources, or defer programs or capital projects, to deal with implementation of the reform. In this scenario it would be unproductive if the resulting failure to meet certain business plan targets were regarded as hard breaches rather than elements of a plan requiring broader assessment.

A business plan has many moving parts and good judgment is required to make a fair assessment of success or failure; missing certain targets could be an indicator of ineffective operational governance, or it could be an indicator of sound performance in difficult conditions and this could only be determined by taking a range of circumstances into account.

#### *1.6. Certain projects are inherently risky*

To fulfill their obligation to act in members' best interest superannuation trustees often consider new ways of delivering services and to respond to technological changes. Such activities, often referred to by the cover-all of innovation, are by their high nature untested and therefore carry some risk of failure either in part or whole. As with business plans, ASFA recommends that APRA be mindful of the risk profile of projects, especially in the digital area. Failure to meet strict targets is not of itself proof of poor planning or governance, given the range of factors that can impact projects during their life span. Indeed, some level of failure is a necessary component of successful innovation.

This further amplifies the need for a balanced assessment focused on process rather than outcomes. If APRA's assessment is too "results orientated" it will discourage appropriate risks being taken by the industry, stymie development and innovation, and lead to worse long-run outcomes for members.

### 1.7. *Reforming 'less well-run funds'*

In the letter of 31 August 2017 APRA states that it has identified RSEs who have performed poorly on an absolute and relative basis and that it intends to correct this by either negotiating a 'robust and implementable' remediation strategy with the RSE or where that is not possible to encourage an orderly transfer of members to another suitable product or RSE.

ASFA supports regulatory intervention that will improve performance and whose basis is clear, appropriate to the individual fund and easy to understand. However there is a weakness in the proposed approach for those RSEs where a transfer to another product or RSE is required as it presupposes that there will always be a successor fund willing to take on the members of the poorly performing RSE.

Given this uncertainty we believe the industry would benefit from a clear and detailed description of the process APRA intends to apply in such circumstances, with particular reference to those cases where a successor fund cannot be found. In particular it is crucial for RSEs to understand how remediation will be enforced where a voluntary successor fund transfer is not possible and what APRA believes the impact will be on the industry as a whole.

## 2. **Fund expenditure and reserving**

### 2.1. *Reporting burden*

As stated in our submission to the *Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017* exposure draft the new reporting standard could add significantly to the reporting burden borne by superannuation funds depending on the level of detail required. Without knowledge of the use APRA will make of the information, it is hard to judge whether the additional reporting burden would be justified.

It would be helpful if examples could be provided identifying the problem or information gap, as well as guidance about how APRA would use the information. Within this, there should also be a clearly articulated and where possible quantifiable member benefit emanating from the additional requirements, rather than mere reliance on the benefits of increased transparency.

## 3. **Assessing outcomes for all beneficiaries**

We are concerned with the following issues in relation to the non-MySuper outcomes test (as it is described in the consultation letter).

### 3.1. *The MySuper outcomes test is not the right model for an all beneficiaries outcomes test*

The net return in MySuper is the primary test of performance and this lends itself to an outcomes test which is designed to provide a comparison, although as we have argued previously care needs to be taken even for MySuper to ensure that this supports an 'apples for apples' comparison.

A different set of considerations apply For example what comparison would be appropriate for a member in a fund which offers individual market options who has chosen a high 'emerging market'

exposure? It would not be appropriate to judge performance against different types of asset allocation and even other emerging market products might not be directly comparable as the weightings might vary substantially. Gross or net benchmarks would be an alternative but even in this area there can be a variety of benchmarks and there is also the question of the benchmark time period.

Choice products have a greater variety of product features and member benefits attached to them than MySuper products and it is difficult to compare them directly, especially with regard to net returns. There are also a variety of elements from which choice members derive value. In the first instance, there is a legitimate question around how APRA can possibly determine that a choice product is not delivering “value for money”, when an individual member has determined otherwise as demonstrated by their investment choice.

APRA may for example determine that a product is relatively expensive, compared with similar products on the market. However, those choosing to enter into those arrangements may be opting to pay a premium for benefits that are important to them. Brand affiliation, trust, service, security and modern technology are examples of such benefits. The “value” attributable to these factors will vary from person to person as it depends on individual preferences and utility functions. APRA should not usurp the role of those members who make a choice, in determining “value for money”.

However, if a choice product outcomes test is established by APRA, it must consider the individual circumstances of the fund including its objectives, processes and operations. Allowance also needs to be made for legacy products which under current legislation cannot easily be transferred to a low cost product. A prescriptive outcomes test that attempted to provide a basis for comparison in a way similar to the proposed MySuper outcomes test is inappropriate.

### 3.2. Risks

As described above we argue that there should be substantial differences between the MySuper and non-MySuper outcomes tests. We are concerned with the potential for the MySuper outcomes test to influence the application of the non-MySuper test over time. The ease of comparison was a fundamental aim of the MySuper architecture but its outward simplicity should not be permitted to colour the design of the non-MySuper outcomes test.

We recommend that a clear delineation be maintained between the two tests and that to support this different terminology be applied. For example, the all beneficiary test could be described as a ‘member best interest assessment’.

### 3.3. ‘Maintaining quality, value for money outcomes’ is a highly subjective test

ASFA supports quality and value for money outcomes for members but we also observe that these tests are fairly subjective and open to debate. As stated above, we recommend APRA resist the temptation to define this test in ultimately quantitative terms and accept the role of judgment on the part of trustees and more importantly fund members, particularly in relation to determining their own measure of value.

## Conclusion

In summary, we recommend that business plan requirements set by APRA are principles-based and relate to a fund's strategic or high level aims.

ASFA acknowledges the need for the regulator to have appropriate powers and access to information to maintain robust regulatory standards. However we would argue that the weight of regulation is already heavy and that it should only be increased further where a clear gap is identified and there is confidence that the additional regulation will act to close that gap at a reasonable cost that ensures an overall and where possible measurable benefit to members.

In that context we acknowledge the thrust of APRA's proposals to strengthen operational governance but we would urge APRA to consider the following:

- Any additional planning, reporting or other obligations should rely on existing resources where possible and the duplication or the reconfiguring of information already available should be avoided
- The operational governance framework requirements should be guidelines for high level and strategic objectives and should avoid operational detail such as internal fund measures or KPIs.
- We would like more information about the reporting burden that 'look through' reporting will involve and the benefits for RSE members clearly explained.
- A clear conceptual distinction should be maintained between the MySuper outcomes test and the all beneficiaries test.

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We would like to thank you for the opportunity to provide comments on the consultation letter and welcome the opportunity to discuss with APRA the matters raised in this submission.

Should you have any questions on any of the matters raised in this submission please do not hesitate to contact me on (02) 8079 0808 or via [gmccrea@superannuation.asn.au](mailto:gmccrea@superannuation.asn.au) or Byron Addison on (02) 8079 0834 or at [baddison@superannuation.asn.au](mailto:baddison@superannuation.asn.au).

Yours sincerely



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