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Consultation: Draft Prudential Practice Guide SPG 516 Business Performance Review - Mercer Submission

Thank you for the opportunity to provide comment on the proposed *Prudential Practice Guide SPG 516 Business Performance Review (Draft SPG 516)*.

General Comments

Mercer generally supports the guidance in Draft SPG 516.

We wish in particular to record our support for the guidance that the first (legislated) outcomes assessment should be in respect of the 2019/20 financial year and be completed after relevant APRA annual statistics are published (expected December 2020).

Clearer guidance in SPG 516 re transition to full BPR

We understand from various APRA communications that it expects trustees to gradually improve the depth and rigour of their BPR and outcomes assessments over time and that APRA will also gradually lift its expectations over time.

APRA's December 2018 Response to Draft SPS 515 submissions (page 22) provided the following guidance:

> *APRA expects that the rigour of the assessment will improve as the industry develops experience in undertaking the assessment. In the first year APRA supervisors will look for reasonable efforts by RSE licensees to conduct the assessment in a comprehensive way and align it with their business planning processes. For some RSE licensees, segmentation in the first year may be at a relatively high level and may have a primary focus on MySuper members due to greater availability of MySuper data. However at least some preliminary assessment of outcomes for all products and members is expected. As RSE licensees develop a more sophisticated approach to identifying cohorts of members, using internal and external metrics and assessing outcomes, a more comprehensive and robust approach will evolve.*

APRA's August 2019 Response to Draft SPS 515 submissions (page 3) provides very similar high level guidance, but omits the more granular guidance provided in December 2018:

> *APRA expects that the rigour of the BPR and its role in the business planning process will evolve as the industry develops experience in undertaking BPRs. In 2020 APRA supervisors will look for reasonable efforts by each RSE licensee to conduct its BPR in a comprehensive manner, including the use of appropriate internal and external data sources.*

We strongly support APRA's approach as indicated above given the requirements are new and will involve a substantial amount of development work by trustees.

However Draft SPG 516 itself provides limited indication of these lower APRA expectations for the initial years of application of SPS 515: Para 4 encourages trustees to view the BPR and outcomes assessment as 'a process of continual improvement' and Para 8 says the BPR 'might develop over time to incorporate more targeted membership cohorts or additional benchmarks and sources of data'.

Mercer's actuarial consulting practice is assisting a range of trustees with the implementation of SPS 515 and is finding some variation between trustees in their views about what depth of cohort analysis will be required in 2020. This indicates to us that further APRA guidance around this point is needed to facilitate consistency of approach across the industry.

Recommendation We recommend that guidance to be added to SPG 516 (perhaps under a 'Transition' heading) to provide clarity that the expected transition to trustees conducting a detailed cohort analysis for all products is expected to take a number of years, as well as to provide more specific guidance about APRA's expectations for 2020, along the lines of that provided in December 2018. We think it is desirable for this guidance to be included in SPG 516 to provide greater clarity about APRA's expectations in the early years of the application of SPS 515 and SPG 516 and so that the remainder of the guidance in SPG 516 can be viewed in this context.

Other Comments

Please refer to the Appendix for our comments on two paragraphs of Draft SPG 516 where we think the wording should be reviewed.

Who is Mercer?

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Mercer Australia provides customised administration, technology and total benefits outsourcing solutions to a large number of employer clients and superannuation funds (including industry funds, master trusts and employer sponsored superannuation funds). We have over $150 billion in funds under administration locally and provide services to over 2.4 million superannuation members and 15,000 private clients. Our own master trust in Australia, the Mercer Super Trust, has around 230 participating employers, around 240,000 members and more than $24 billion in assets under management.

Please contact me on [redacted] or by email to [redacted] if you would like to discuss this submission.

Yours sincerely

[redacted]

Paul Shallue
Manager, Research & Policy

Appendix - Other Comments

A1. Paragraph 39 – longevity products

This paragraph reads:

> *39. Where an RSE licensee offers longevity products such as annuities or other risk pooling products, the metrics might reasonably encompass measures of the long-term sustainability of the products, including trends in the pool of members holding the product. These measures will assist the RSE licensee to plan and take action, for example to ensure that members do not continue to hold high cost and poorly performing retirement products.*

While we understand the (unexpressed) thinking behind the second sentence, it may be read as suggesting that APRA has a negative view about the likely cost and performance of longevity products. We note that there are no other references in SPG 516 to 'high cost' or 'poorly performing' products. We suggest re-wording along the following lines:

> *39. Where an RSE licensee offers longevity products such as annuities or other risk pooling products, the metrics might reasonably include (as well as those referred to in paragraph 38) measures of the long-term sustainability of the products, including trends in the pool of members holding the product. These measures will assist the RSE licensee to plan and take action if, for example, its forward-looking analysis indicates that the projected pool would be insufficient to enable the product to continue to meet members' expectations in taking up the product, based on product disclosures.*

A2. Paragraph 41 – defined benefits

This paragraph reads:

> *41. For defined benefit cohorts, the requirements under Prudential Standard SPS 160 Defined Benefit Matters would be central to an RSE licensee's analysis under the business performance review. An RSE licensee should be able to demonstrate, on the basis of actuarial advice, that the future benefits of members are fully funded.*

We are concerned that '*the future benefits of members are fully funded'* implies that both past and future benefit accruals must be covered by current assets, which is inappropriate. We suggest a refinement along the following lines:

- *that the future benefits of members are expected to be fully funded by the time they become due and payable*

If other alternatives are being considered, we think care will need to be taken that SPG 160 does not, in effect, introduce new funding requirements over and above those of SPS 160. We do not think this would be appropriate. For example, a change to draft paragraph 41 to refer to the 'accrued' (rather than 'future') benefits of members being fully funded would (in our view) be problematic, as SPS 160 does not require this.