



26 September 2018

Ms Heidi Richards
General Manager,
Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority

Email: superannuation.policy@apra.gov.au

Dear Ms Richards

Re: Post-implementation review of APRA's superannuation prudential framework

In brief:

There are several reviews either in progress or recently completed that may affect the ability of APRA to provide a full review of the framework at this point in time. We recommend that there be a further post implementation review to consider the final report of the Royal Commission into Banking, Superannuation and Financial Services, as well as Productivity Commission reports, other recent APRA reviews, and initial industry feedback. The role of the standards - as opposed to the guidance - could be strengthened by clarification.

We thank APRA for the opportunity to make a submission.

AIST supports the ongoing development and review of APRA Prudential Standards. We strongly agree with the purpose of the Prudential Standards - that they be forward looking, primarily risk based, consultative, clarify matters set out in the legislation (particularly where little detail is provided), and be consistent with international best practice. The purpose of the post implementation review is to ensure that the Prudential Standards continue to reflect best practice and remain effective and relevant.

There needs to be stringent consideration of the issues facing the industry from both an operational perspective as well addressing what is in members' best interests. These issues go to the heart of the reasons for prudential regulation. The superannuation industry is currently subject to multiple reviews and inquiries some of which deal with matters that are directly relevant to the prudential standards framework. AIST believes that the post-implementation review cannot be meaningfully conducted without the following four key issues being examined and the results included within the review:

- APRA's own insights.
- New APRA requirements.

- Insights from the substantive reviews which are in train.
- AIST's Governance Code 2017.

We examine each of these below. These seemingly have not formed part of the post implementation review to date. Accordingly, our letter to APRA of 24 August 2018 requested that the post implementation review be deferred until after the policy considerations from the Financial Services Royal Commission (FSRC) have been analysed.

While we understand that the review will continue, we recommend that a further post implementation review occur following the FSRC final report expected in February 2019.

In the interim, we also provide below our initial feedback regarding the prudential standards. Any further post implementation review could commence with APRA issuing a paper outlining how key findings from APRA, key findings from the substantive reviews, a review of the AIST Governance Code, and initial industry feedback might impact the prudential standards.

Four key issues which require examination to ensure a meaningful prudential standard review

1. APRA's own insights

APRA has a variety of sources which may impact whether the prudential standards are fit for purpose. These include:

- Outcomes from APRA supervision.
- APRA thematic reviews.
A good example is how does APRA's thematic review of related party arrangements impact the review of prudential standards. The impact of poor related party arrangements was also highlighted in the FSRC hearings.
- Inquiries undertaken by APRA.
A good example is the prudential inquiry into the CBA. The findings of this report point to a need to change the prudential standards regarding outsourcing, conflicts of interest, risk management, and general board oversight. This report also highlights the need to comply with international best practice – which is one of the purposes of the prudential standards.
- The impact of circulars which have been issued to Trustees – for example, *Superannuation Circular No. III.A.4: The Sole Purpose Test*.

2. New requirements

As new and important requirements emerge, these will impose additional governance obligations on trustees. These would also potentially trigger a further review of the prudential standards or (as is the case with the APRA member outcomes test) the development of new standards.

We appreciate APRA's consultation to date. A further example is the ASIC product design and distribution obligations, if enacted.

3. Insights from the substantive reviews which are in train

The prudential standards must aid meeting the members' best interests test. Several of the principles contained in the prudential standards and guides under review have been the subject of significant evidence tendered to FSRC. These include:

- Conflicts arising from multiple directorships.
- Conflicts associated with related party arrangements.
- Conflicts arising from a responsiveness to shareholders as opposed to members of the superannuation fund.
- Conflicts arising from entities which is the trustee of an RSE as well as the RE of a managed investment scheme.
- How conduct which is deliberately not in members' best interest is to be addressed.

The Productivity Commission is also dealing with matters covered by the prudential standards. These include:

- A lack of data to enable benchmarking of fees, costs and performance. For example, this lack impacts SPS 530 requirements to develop measurable objectives.
- Governance issues some of which relate to the management of conflicts of interest and which have also been highlighted by the FSRC.

Before we turn to our interim feedback about the prudential standards, we reiterate our recommendation that there be a further post implementation review following the FSRC final report.

4. AIST Governance Code

AIST has developed a Governance Code¹ which is mandatory for AIST member funds. The Code could be examined to determine which elements could be added to the Governance prudential standard. AIST would be pleased to discuss this with APRA.

Interim feedback

Data to inform APRA and industry

¹AIST (AIST Governance Code 2017. [online] AIST, Available at: <https://tinyurl.com/y8rz5rr3> [Accessed 26 Sept 2018].

AIST has consistently advocated that Choice reporting should be aligned with MySuper fees, costs and performance reporting. This is an important baseline issue requiring attention so that the prudential standards may work more effectively. Without such alignment, APRA cannot easily identify, for example:

- The poor value impact of conflicts of interest and other forms of misconduct on member retirement savings.
- Systemic switching of members into poor performing, high cost superannuation products.
- Whether investment performance is delivering fair value.

Role of Prudential Practice Guides

The role of APRA's guidance material is specific to the material itself, with the role of Prudential Practice Guides noted in the introduction to the PPGs themselves (as well as the discussion paper) being that "Prudential practice guides (PPGs) provide guidance on APRA's view of sound practice in particular areas. PPGs frequently discuss legal requirements from legislation, regulations or APRA's prudential standards, but do not themselves create enforceable requirements."

APRA does not expressly state that opinions provided in the PPGs form an illustration of APRA's interpretation of the legal requirements underpinning the PPG and has in fact expressly disclaimed each of the guides. This contrasts with ASIC's regulatory guidance, which is considered to be, in part, a statement of ASIC's interpretation of the law. However, the PPGs include comments such as "APRA expects that ...", while there is the inference that end users of the guides may not rely on such a statement. While AIST does not necessarily disagree with the roles explained above, we seek clarification.

Format

The current format of the prudential standards could include information about the objective of the standard, principles for driving the standards, then include the current form of guidance.

It would also be useful to cross-reference any inter-relationship with other guides, standards and relevant APRA papers.

Feedback obtained by AIST is that the prudential standards could be enhanced by examples. Examples could be in the form of risk assessment templates and other practical guides to compliance. We believe that the appropriate place for these to be provided is in any guidance provided by the regulator.

Governance

The AIST Governance Code goes beyond the prudential standards. We suggest that the additional requirements be included in the prudential standard.

Our other key concerns relate to those matters which are being covered by both the FSRC and the Productivity Commission – mainly relating to conflicts of interest, as we have outlined above.

Risk management

AIST considers that the provision of good practice risk appetite statements as examples should be included in the prudential standards.

Operational financial reserving

Clarification is sought regarding the intent of the prudential standard:

- Is it to gauge the purpose, use and visibility of the OFR and that other moneys may be being used instead of the OFR?
- Or is the intent is to help funds set a reserving level (in which case 25bps may be being used as a default)?
- Or is the intent to gauge operational management risk at the extreme or for any operational risk?

AIST notes the above matters have been discussed within the FSRC.

Funds have commented that there is a need to examine reserving holistically.

AIST also queries what is meant by 'materiality' in the context of drawing on the OFR.

Outsourcing

Both the FSRC and the Productivity Commission have raised concerns regarding outsourcing – these concerns include a lack of suitable arms-length oversight in the case of related party transactions. AIST reiterates its recommendation to take such reviews into account, as well as APRA's own recent review of related parties.

AIST member funds have commented that this prudential standard was written in a very different context. There exist several different outsourcing risks such as cloud computing. We note APRA's recently released information paper regarding outsourcing cloud computing services. This and other developments should be taken into account.

We also raise the issue of how to include oversight and fostering of appropriate behaviours in outsourced organisations.

Investments

There are several issues which require resolution for the Investments prudential standard to work effectively, including:

- Taxonomies – for example, what is meant by growth or defensive.
- Investment matters will be impacted by the ASIC product design and distribution proposals.

Insurance

There are matters before both the FSRC and the Productivity Commission which need to be considered once final reports have been released.

For further information regarding our submission, please contact Richard Webb, Policy & Regulatory Analyst at 03 8677 3835 or at rwebb@aist.asn.au.

Yours sincerely,



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 \$1.2 trillion 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.