

## Superannuation (prudential standard) determination Nos. 2 and 3 of 2019

### EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

*Superannuation Industry (Supervision) Act 1993*, section 34C

Under subsection 34C(1) of the *Superannuation Industry (Supervision) Act 1993* (the Act), APRA has the power to determine standards (prudential standards), in writing, in relation to prudential matters to be complied with by all RSE licensees of registrable superannuation entities (RSEs).

On 2 December 2019, APRA made Superannuation (prudential standards) determination No. 2 of 2019 which determines a new *Prudential Standard SPS 515 Strategic Planning and Member Outcomes* (SPS 515).

On 4 December 2019, APRA made Superannuation (prudential standards) determination No. 3 of 2019, which revokes *Prudential Standard SPS 220 Risk Management* (existing SPS 220) made under Superannuation determination No. 2 of 2012 and determines a new *Prudential Standard SPS 220 Risk Management* (SPS 220).

The instruments commence on 1 January 2020.

#### **1. Background**

APRA's mandate is to ensure the safety and soundness of prudentially regulated financial institutions so that they can meet their financial promises to depositors, policyholders and fund members within a stable, efficient and competitive financial system.

APRA carries out this mandate through a multi-layered prudential framework that encompasses licensing and supervision of institutions. APRA is empowered under the Act to issue legally binding prudential standards that set out specific prudential requirements with which APRA-regulated institutions in the superannuation industry must comply. These standards are supported by prudential practice guides which clarify APRA's expectations with regard to prudential requirements.

Since 2017, APRA has undertaken extensive consultation with industry on the introduction of new prudential requirements for RSE licensees to lift industry wide strategic planning and ensure a focus by all RSE licensees on the delivery of quality member outcomes.

SPS 515 sets new requirements for an RSE licensee to annually review its performance in achieving its strategic objectives, including the delivery of member outcomes, supported by sound strategic and business planning and expenditure management; and supports the introduction of the product-based member outcomes assessment under section 52 of the Act.

Existing SPS 220 sets out requirements for each RSE licensee in regards to effective risk management, breach reporting and strategic planning. The strategic planning aspect of existing SPS 220 requires each RSE licensee to maintain a rolling three to five year business

plan that covers the entirety of its business operations. Existing SPS 220 also specifies the role of the Board and the frequency of required updates to the business plan.

### **Purpose of the instruments**

The purpose of Superannuation (prudential standards) determination No. 2 of 2019 is to determine SPS 515 and set out in SPS 515 new prudential requirements for an RSE licensee to annually review its performance in achieving its strategic objectives, including the delivery of member outcomes, supported by sound strategic and business planning and expenditure management; and to support the introduction of the product-based member outcomes assessment under section 52 of the Act.

The purpose of Superannuation (prudential standards) determination No. 3 of 2019 is to revoke and replace existing SPS 220 with a new version of the standard. The changes to SPS 220 are minor and intended to ensure the core strategic objectives and business planning requirements are located in SPS 515.

## **2. Operation of the instruments**

SPS 515 requires an RSE licensee to:

- approve strategic objectives that support it in achieving the outcomes it seeks for beneficiaries and the sound and prudent management of its business operations;
- maintain a Board approved business plan that sets out the approach for implementation of its strategic objectives;
- undertake annually a business performance review to assess its performance in achieving its strategic objectives and to incorporate any actions to improve performance in its business plan;
- ensure that decisions to incur significant fund expenditure support it in achieving its strategic objectives and that those decisions are monitored against their expected outcomes; and
- ensure the outcomes assessment required under section 52(9) of the Act addresses the additional factors set out in SPS 515.

The revised SPS 220 requires an RSE licensee to:

- maintain a risk management framework that is appropriate to the size, business mix and complexity of its business operations;
- maintain a Board-approved risk appetite statement;
- maintain a Board-approved risk management strategy that describes the key elements of the risk management framework that give effect to the approach to managing risk;
- maintain adequate resources to ensure compliance with this Prudential Standard; and

- notify APRA when the RSE licensee becomes aware of a significant breach of, or material deviation from, the risk management framework, or discovers that the risk management framework does not adequately address a material risk.

Where SPS 220 and SPS 515 refer to an Act, Regulation, Prudential Standard or Reporting Standard, this is a reference to the document as it exists from time to time, and which is available on the Federal Register of Legislation at [www.legislation.gov.au](http://www.legislation.gov.au).

### *Merits review*

The prudential standards provide for APRA to exercise various discretions. Decisions made by APRA exercising those discretions are not subject to merits review. This is because these decisions are preliminary decisions that may facilitate or lead to substantive decisions which are subject to merits review.

Under the Act, it is a condition on all RSE licences that the RSE licensee must comply with the RSE licensee law, which includes prudential standards. However there are no penalties prescribed for breach of the prudential standards under the Act. Instead an RSE licensee's breach of an RSE licence condition is grounds for APRA to make further, substantive decisions under the Act in relation to the RSE licensee. Those decisions are, as the case may be:

- (a) to cancel a licence to operate an APRA-regulated superannuation fund (section 29G of the Act); and
- (b) to issue a direction to the RSE licensee, including a direction to comply with the whole or part of a prudential standard (section 131D of the Act).

It is only at this stage that an RSE licensee is exposed to a penalty: loss of licence or 100 penalty units each day if it breaches the direction (section 131DD of the Act<sup>1</sup>). The subsequent substantive decisions of APRA to impose a direction are subject to merits review.

### **3. Consultation**

APRA consulted widely on SPS 515 and SPS 220. Consultation commenced on updates to the prudential framework in August 2017. A further round of extensive consultation was undertaken from December 2017 to March 2018, following the release of a discussion paper,

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<sup>1</sup> The exception is section 54B of the Act, which provides that breach of a covenant under sections 52 or 52A is a civil penalty provision. The covenants include a requirement to comply with prudential standards in relation to specified topics (conflicts, capital requirements for operational risk, MySuper and choice products). CPS 220 is not a standard in relation to any of these topics. Paragraph 23 of SPS 515 provides relevant matters an RSE licensee must assess for the purpose of determining whether the financial interests of members who hold a MySuper or choice product are being promoted by the trustee under section 52(11)(e) of the SIS Act. Decisions made by APRA exercising discretions in relation to paragraph 23 of SPS 515 are not subject to merits review. APRA requires transparent and accurate assessments of MySuper and choice products from RSE licensees to monitor an RSE licensee's compliance with the covenant in section 52 of the SIS Act. Uncertain or inconsistent assessments can compromise APRA's ability to effectively supervise an RSE licensee. APRA's decisions to exercise discretion in relation to paragraph 23 of SPS 515 are therefore important financial decisions with a significant public interest element, the outcomes of which must be final to provide certainty for the regulated entities in the fast moving regulatory environment.

draft prudential standards SPS 515 and SPS 220 and supporting guidance. Generally, industry stakeholders were supportive of the intent of the proposed changes. However, concerns were raised regarding the level of prescription proposed in some areas and some aspects of implementation. Some of the more prescriptive elements were removed from the business performance review requirements in response and further clarity was given about implementation expectations. APRA released final prudential standards and supporting guidance in December 2018.

Following the passage of the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures) No.1 Act 2019* (the Member Outcomes Act) in April 2019, APRA determined that corresponding changes were required to SPS 515. APRA consulted on the proposed changes to SPS 515 from April 2019 to May 2019. Stakeholders expressed broad support, however some drafting issues were highlighted and further guidance requested. In response, APRA made drafting amendments where appropriate and sought to provide further guidance on the key components of SPS 515.

#### **4. Regulation Impact Statement**

In agreement with the Office of Best Practice Regulation (OBPR), APRA prepared an independent review of the regulatory impacts of the prudential framework changes released in December 2018. This included the revision of SPS 220 and the introduction of the new standard SPS 515. The independent review is available at <https://ris.pmc.gov.au>.

Following the passage of the Member Outcomes Act, APRA made consequential changes to SPS 515. The OBPR advised that a Regulation Impact Statement was not required for the later changes to SPS 515.

#### **5. Statement of compatibility prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011**

A Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* is provided at Attachment A to this Explanatory Statement.

## ATTACHMENT A

### Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

#### **Superannuation (prudential standard) determinations Nos. 2 and 3 of 2019**

These Legislative Instruments are compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (HRPS Act).

#### **Overview of the Legislative Instruments**

The purpose of these instruments is to revoke *Prudential Standard SPS 220 Risk Management* determined by APRA in 2012 and replace it with a new *Prudential Standard SPS 220 Risk Management* (SPS 220), and to determine *Prudential Standard SPS 515 Strategic Planning and Member Outcomes* (SPS 515). The instruments set out prudential requirements for RSE licensees to lift the quality of strategic planning and the focus on member outcomes across the industry.

SPS 515 requires RSE licensees to assess past performance, including taking into account the legislated outcomes assessment, and identify areas for improvement in future. These requirements are envisaged to enhance the sound and prudent management of all RSE licensees' business operations and drive the sustainable delivery of quality outcomes to members across the superannuation industry.

SPS 220 is being remade to ensure the core strategic objectives and business planning requirements are located in SPS 515.

#### **Human rights implications**

APRA has assessed the instruments against the international instruments listed in section 3 of the HRPS Act and has determined that the instruments do not engage any of the applicable rights or freedoms. Accordingly, in APRA's assessment, the instruments are compatible with human rights.

#### **Conclusion**

These Legislative Instruments are compatible with human rights as they do not raise any human rights issues.