AIST

21 December 2022

Financial Regulator Assessment Authority
The Treasury
Langton Crescent
PARKES ACT 2600

Email: FRAA@treasury.gov.au

Dear Sally,

Effectiveness and capability review of the Australian Prudential Regulation Authority

Brief

In AIST's view, APRA's supervisory activities are well-regarded but would be improved by increased superannuation resourcing and skills, better communication with regulated entities and between government agencies, and by greater scrutiny and accountability of Choice products.

About AIST

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 superannuation funds.

As the principal advocate and peak representative body for the $1.7 trillion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST advocates for financial wellbeing in retirement for all Australians regardless of gender, culture, education, or socio-economic background. Through leadership and excellence, AIST supports profit-to-member funds to achieve member-first outcomes and fairness across the retirement system.

Submission

AIST thanks FRAA for the opportunity to provide input into this consultation, in which we:

- Explain the basis of our engagement with APRA, and the rationale for our comments on APRA's supervisory activities.
- Provide high-level comments on key issues impacting on the effectiveness and capability of APRA's supervisory functions.
- Address the key questions posed by the review about APRA's supervisory functions in superannuation.
- Comment on APRA's resolution function at an entity and industry level.

Recommendations

- *There should be increased supervisory activity relating to Choice products to ensure they meet the same standards applying to MySuper products. This should include increased scrutiny of their performance, fees, related party arrangements, members outcomes and sustainability.*
- *Increased resourcing is needed for supervisory teams, and ongoing superannuation skill gaps should be addressed as a priority.*
- *APRA's overall priorities should be clearly and explicitly reflected in entity-level supervisory activities and plans.*
- *APRA supervisory activities should explicitly facilitate fund consolidations.*
- *Regulatory guidance should support a principles-based prudential regime.*
- *Transition to data-driven supervision should supplement, not replace, existing supervision.*
- *Better and earlier co-ordination between Government agencies is needed*
- *Post-implementation reviews of regulatory change may reduce the regulatory impost of supervisory activities.*
- *APRA should establish an annual program of confirmation and discussion with each super fund about their SRI score, with a view to more effectively and explicitly addressing supervisory risk issues, and publish further details of APRA's proposed resolution framework, including relationship to other supervisory activities and SRI.*

AIST perspective and approach to the FRAA review

AIST welcomes the opportunity to make this submission to the Financial Regulator Assessment Authority and acknowledges the important role FRAA plays in bringing extra scrutiny and accountability to financial regulators.

As the industry association representing APRA-regulated profit-to-member superannuation funds, with regular and in depth engagement with APRA, AIST is well-placed to comment on APRA's effectiveness and capability.

AIST made a submission to the 2019 APRA Capability Review, and has been actively engaged with APRA since AIST's inception over 20 years ago.

AIST continues to engage with APRA on a regular basis in relation to financial services and all superannuation-related issues, including all consultations on prudential standards; data collection, reporting and publications; and legislative implementation. This engagement involves one-on-one meetings; both AIST- and APRA-facilitated industry roundtables; and the preparation of submissions on APRA consultations.

In addition, AIST meets with APRA in industry forums (such as the ATO Superannuation Industry Stewardship Group); in regular joint meetings with ASIC; and has numerous formal and informal meetings with APRA on a wide range of subjects.

APRA has also presented at various AIST forums about their activities and priorities.

We routinely talk to our member funds about their engagement with APRA and other regulators, and about a wide range of regulatory issues. AIST has also discussed specifically this review at forums of AIST member funds, and in a series of individual in-depth interviews with senior APRA-facing staff of six RSEs.

While we have received much positive feedback about APRA, including in relation to the interaction between super funds and their supervisory teams (with this also reflecting the overall positive relationship between APRA and AIST), it is in the nature of such exercises that many of our comments relate to where there appears to be opportunities for improvement.

While we appreciate this review's focus on supervision and resolution, our submission also addresses related questions of engagement around the development and implementation of prudential architecture, data reporting and publications and other consultations.

We have read the reference to "specialist and risk functions relating to superannuation" as referring to these other activities, and note that developments and activities in these areas impact both directly and indirectly on supervisory activities.

Key issues impacting on the effectiveness and capability of APRA's supervisory functions

Ensuring consistent and comparable outcomes across regulated industries and throughout superannuation is critical threshold requirement for supervision

APRA has a multi-faceted mandate that requires it to balance the allocation of resources and focus between banking, insurance and superannuation; and within superannuation, to balance the interests and protection of superannuation fund members with the stability of the superannuation system. This is a challenging remit in the context of finite resources and one that APRA generally fulfills well.

In our submission to the 2019 capability review, we called out the need to increase APRA's focus in superannuation on members best interests. The Government has responded to similar comments by the Productivity Commission and others by introducing an elevated member outcomes test, and more recently, a Best Financial Interests Duty.

The outcomes assessment, superannuation product heatmaps and Performance Assessment is now more central to APRA's regulatory approach, and helps detect and expose poor performance in relation to some (but not all) types of superannuation products. This in turn informs how APRA prioritises its supervisory effort.

This is a significant improvement, and AIST recognises that it is an evolutionary process. However, it appears to remain the case that the entities and products providing the most information to APRA and disclosing the most information to their members and the public (e.g., MySuper products), are still the ones subject to the greatest scrutiny.

Conversely, the products that have only recently started to provide detailed reports to APRA have (as a whole) lower performance and higher fees than MySuper products, are subject to lesser scrutiny. Many choice products are still not yet assessed in heatmaps. While there have been MySuper heatmaps since 2019, there has only been one Choice heatmap – with the scheduled 2022 Choice heatmap delayed until 2023, again because of "data issues".

This is an enormous supervisory (and consumer protection) gap in the context of products that make up a significant proportion of products (approx. $859 billion is invested in APRA regulated products that are not MySuper – compared to $683 billion in MySuper) and a substantial proportion of underperformance. What is more, members in choice products cannot always or easily compare the returns and costs of their product with benchmarks or with other products.

If APRA do not have the capacity to receive and assess consistently reported data, including about performance and fees, for a large proportion of superannuation products, this must impact on supervisory activities in relation to the manufacturers of these products. This has been regularly commented on by superannuation Inquiries the past twelve years but is particularly relevant to any consideration of APRA's supervisory capabilities.

For over a decade, the lack of data and comparability has been used as a cloak to protect some products from scrutiny (including supervisory scrutiny) and detailed regulatory attention. With the ongoing implementation of Superannuation Data Transformation and the delayed reporting of data to APRA for almost all superannuation products, APRA should now confirm that, consequentially, a consistently applied supervisory approach will be in place within a finite period.

There should be increased supervisory activities on new and newly reporting products to ensure they meet the same standards applying to other products. This should include increased scrutiny on their performance, fees, related party arrangements, members outcomes and sustainability.

It is unclear why the current (but not yet complete) choice product heatmaps do not include an assessment of the sustainability of products: both the heatmaps and supervisory activity in relation to these products should include consideration of sustainability.

Increased resourcing is needed for supervisory teams

That this has not happened earlier, also speaks to the relative level of skills and resourcing for superannuation within APRA. There are both upstream and downstream reasons and other consequences for this.

While APRA staff are highly qualified, especially in specialist teams, some supervisory staff do not have as much financial services experience. Where they do have this experience, it tends to be more banking than superannuation-specific experience and is often quite generalist in nature.

In our interviews with member funds, interviewees who have banking expertise have noted that banks seem to remain the area of greatest focus by APRA and that superannuation seems to receive less priority as a result. It has been suggested that there are many more APRA personnel with banking and RBA experience than with superannuation experience, and AIST suggests that the relative skill levels be examined by FRAA.

From an international perspective, there is also a larger body of research, knowledge and benchmarks about banking than there is about pension funds, especially in defined contribution environments. It is therefore harder to find and utilise international benchmarks and apply international experiences to Australia, and this too impacts on overall supervision.

There is also greater diversity in pension systems across the world than there is in banking or indeed other types of financial service. This results in a similarly wide diversity in supervisory approaches. In systems similar to Australia (e.g., Netherlands), much of the pension fund focus has been on governance, remediation and risk management. While this is important, the greater and recently increased Australian focus on member outcomes and best interests is not always supported by international comparisons and benchmarks.

Recent changes to superannuation law provided a clear and explicit member outcomes and best interest focus and powers, that should help steer supervisory activities in the same direction. What is additionally need is greater superannuation-skilled resources.

While AIST understands the rationale for greater integration of superannuation with other parts of financial services (such as in relation to CPS 234 Information Security and CPS 220 Risk Management), this should not and must not be at the expense of a focus on superannuation or lead to the application of a generalised approach that is not suited to the special features of superannuation.

In particular, loss from the perspective of other regulated entities relates to immediate failure or financial loss of regulated entities, while from a superannuation perspective primarily relates to loss of member value arising from entities not acting in members' best interests. That is, recognising that superannuation has characteristics of both a financial product and social welfare.

While there are a smaller and decreasing number of APRA-regulated super funds, unfortunately this has not meant that APRA skills and resources are better matched or are able to better handle supervisory requirements. For example, the increased number of investment professionals within funds has not been matched by an increased number of increased professionals within APRA.

Super funds are now larger, have greater resources and skills in a wider range of areas, rely less on outsourced expertise, and are increasingly attracting high quality staff from throughout financial services and related areas.

Assessment of the effectiveness and capability of APRA's supervision function in superannuation

1. *Are APRA's supervisory priorities clearly communicated by APRA staff to the regulated population and external stakeholders?*

Yes, to the industry as a whole but less so at an individual regulated entity level.

The superannuation priorities articulated APRA's Corporate Plan are clearly stated and consistent with the observed activities of APRA and its staff at a superannuation industry level.

The relationship between APRA and the profit-to-member superannuation funds it regulates is generally positive, with funds reporting that they find APRA to be accessible and engaged with funds, especially through prudential supervision activities. The supervisory teams are transparent and co-operative in their fund engagements and help facilitate meaningful prudential review processes.

However, there is sometimes a disconnect between APRA's publicly-stated superannuation priorities articulated at an industry level, and the focus observed by super funds at an entity level. Similarly, some requests for information from funds about their position in relation to specific issues, including issues identified by APRA as a priority, are not responded to.

APRA participation in industry forums is regularly sought by AIST. This is often to help communicate its activities in relation to new initiatives and associated supervisory activities, and to promote a positive dialogue between the industry and APRA.

Many personnel across APRA are willing and able to participate in these forums and have greatly contributed to APRA-industry collaboration when they have. However, APRA is not always available to speak at these forums.

Invitations for APRA participation sent via the APRA conference address are sometimes declined or subject to a slow response. However, invitations sent directly to the relevant APRA personnel are more likely to be accepted.

2. *Does APRA clearly communicate and implement its supervision activities, and are supervision activities appropriately targeted?*

APRA's overall priorities should be clearly and explicitly reflected in entity-level supervisory activities and plans

Supervisory priorities may be clearer more visible at an industry than at an individual RSE level. At an individual regulated entity level, the level of clarity ranges from clear to not so clear.

The comments in this section identify specific issues that have been reported to AIST, largely through interviews related to this review, and may not reflect the experiences of funds as a whole.

One fund has observed that APRA's superannuation priorities do not seem to bear a relationship with the APRA's priorities for that fund. Funds would have greater clarity about the supervision activities directed to each fund if APRA was able to share their fund specific-plans with each fund.

Some funds have reported to AIST that the nature of engagements with APRA can tend to be ad hoc and individual request-driven rather than anchored to an identified supervisory priority or concern. While funds respond to these inquiries, it can be difficult to contextualise them, and have a confident understanding that the information being provided is the information sought.

This can be compounded when regular meetings with super funds are cancelled on the grounds that APRA does not have sufficient resources to meet with funds on a regular basis. Given that one fund reported receiving over 300 emails from APRA this year, it raises the question about whether the inquiries in those emails could have been more efficiently handled through the structure of a regular meeting or some other organising process.

It is in members best interests for both the regulator and the regulated to commit to efficient, expeditious and well-defined communications. This should mean considered and properly focused questions by the regulator, preferably accompanied by a reason, and an accurate, timely and focused reply by the fund.

A consequence of the ad hoc approach is that even simple and straightforward issues can take longer than necessary to resolve.

AIST is aware of an issue where a fund breached a time requirement for a notification for a requirement (affecting relatively few members) by a few days following the identification of a data error. The fund acknowledges that it did not meet the time requirement, has fixed the error, and was prepared to accept the regulatory consequences. However, this triggered a chain of questions from APRA and responses from the fund that continued for months, without a clear endpoint and which was apparently disproportionate to the fund's breach.

3. *How effective is APRA's supervision in achieving APRA's objectives? Are there any gaps in APRA's supervisory activities in superannuation?*

In some instances, there appears to be a disconnect between APRA's objectives and its supervisory activities. This is particularly apparent in relation to the super fund consolidation. This can be exacerbated by APRA limiting the amount of regulatory guidance given, especially in relation to new requirements; and by ongoing skills and experience gaps in frontline supervisory teams.

While APRA must react to changes in the external environment – and these have been substantial in recent years – some funds have also observed a tendency for APRA to be reactive to events, sometimes at the expense of day-to-day activities.

While high profile issues like culture and governance are of enormous importance, other issues such as managing operational risk, may have taken a back seat in recent years. AIST is not able to assess the internal allocation of resources within APRA, but the FRAA should examine and assess whether there is a basis to this observation.

APRA supervisory activities should facilitate fund consolidations

Discussions about mergers, the negotiation of merger terms, resolution of technical, legal and taxation issues, and implementation of mergers has been a high priority for many super funds. For APRA, promoting the consolidation of super funds has also been a high priority.

However, it has been reported to AIST that APRA does not always come to the table with super funds with a "let's make this happen" attitude.

An apparent lack of familiarity with mergers and merger processes, appears to make APRA often adopt a cautious and conservative approach to mergers. This can mean that the focus is on relatively minor technical (and generally not contentious) issues, and that this slows the momentum and focus on achieving the merger. This can make it seem that process is getting in the way of good outcomes.

In order to cascade the high-level priority of promoting super fund mergers down to practical and supervisory levels, AIST suggest that consideration be given to:

- Specific encouragement to APRA supervisory teams to increase the efficiency of achieving consolidation objectives.
- APRA participation in technical merger discussions with both merging super funds at the same time and on request.
- Expediting applications for relief in relation to mergers.
- Providing guidance on non-contentious merger issues.
- Adopting risk-based approach to merger issues (so that issues are properly prioritised).

Regulatory guidance should support a principles-based prudential regime

APRA is moving towards more principles-based regulation, as evidenced by the current Modernising Prudential Architecture project. This is intended to support a more, flexible, adaptable and wide-ranging approach.

AIST supports this principle-based approach as greatly preferable to a prescriptive, checklist approach - provided it is able to recognise the specific and unique characteristics of superannuation, and is supplemented by practical examples, case studies and scenarios. This is not a call for "proxy regulation by example", but for a pragmatic approach that reinforces the expectations of regulation and illustrates how the policy objectives of the regulation can be achieved.

The use of regulatory guidance is particularly important in relation to new or modified regulations and provides guardrails and enhances consistency (while not stifling innovation) for both the regulator and the regulated.

For example, it would have been useful for APRA to have issued facilitative guidance in relation to the implementation of the new Best Financial Interests Duty that was an important element of the Your Future Your Super package of reforms. In the absence of such guidance, various funds have reported receiving a range of specific but ad hoc Best Financial Interests Duty questions from APRA.

Another manifestation of an insufficiently supported principles-based approach is the initial "hands-off" approach, that is then replaced by increased prescription if the regulator is not satisfied by the approach taken by the industry and individual entities. This was particularly apparent in the implementation of Protecting Your Super/Putting Members Interest First packages in 2019.

Ongoing superannuation skill gaps should be addressed as a priority

In specialist and high-level roles, engagement with APRA is effective and capable. However, the experience of funds with frontline supervision is more variable reflecting different levels of skills and experience amongst teams.

In its direct dealings with APRA, AIST consistently deals with highly skilled and knowledgeable personnel who are committed to strong outcome focus in superannuation. For example, this has been particularly apparent in relation to Superannuation Data Transformation and Investment Risk.

In relation to data reporting, the current Superannuation Data Transformation project is finally resulting in APRA updating its superannuation reporting standards and collecting product level data that facilitates assessments of outcomes. This also mean that there is increased comparability of products, now covering MySuper products and some Choice products, and hopefully extending to all superannuation products.

Many of these initiatives were to have been implemented in response to the Superannuation System Review of 2010 and have been the subject of various but delayed timelines. However, it is pleasing they are now being implemented.

The creation of a Superannuation Division has also improved APRA's focus on the overall performance of the superannuation system for members.

However, variability in skills capability remains evident amongst superannuation supervisory teams and this does not always result in consistent and high-level outcomes.

While some staff have long superannuation industry experience, the value of this experience is not available in all supervisory teams. For example, AIST has been advised of a senior superannuation supervisor who had no superannuation experience prior to their appointment by APRA.

While APRA is demonstrating an increased and welcome focus on member outcomes, there is some variability in the focus and areas of interest between teams that leads to the perception this seems to reflect the interests of individuals and their managers.

Discussions with funds identified several common themes where funds felt that APRA could be more effective both in their engagement with funds, and in the delivery of their statutory mandate:

- The lack of financial services experience also meant (in the view of all respondents) that staff had limited real-world commercial experience and understanding of operational frameworks.

- Respondents provided various suggestions about how supervisory activities could be supplemented by other forms of engagement such as greater engagement with funds' external and internal audit functions, and pro-active information sharing with ASIC in relation to the fund overall and about specific issues.

- All respondents felt that APRA should provide greater and ongoing level of feedback to funds about their specific performance, areas for improvement and comparison with other industry participants. In particular, it was suggested by some funds that APRA share their rolling annual supervisory plan with funds.

- The profit-to-member sector uses outsourced service providers to a greater extent than many financial service entities. While these funds adhere to the outsourcing prudential standard and recognise that the Trustee has ultimate responsibility for their fund, there is sometimes tension between the controls they use and APRA expectations. Who performs the control testing and the standards to which the controls are tested needs to be addressed at an industry level in order to support more efficient supervision.

    - Given the imminent introduction of the revised prudential standard on investment governance (SPS 530), this is a live issue in relation to valuations. Some funds do not undertake valuations in-house but outsource valuations to an expert third party provider. Valuations and valuation methodology are subject to rigorous oversight by a combination of board and management processes.

- In both supervisory activities and practice guidance, there should be greater recognition by APRA that funds can meet their fiduciary duties and promote members best financial interests in a range of ways rather than in a rigid frame

- While it may be administratively convenient for a regulator to encourage a standardised approach to compliance and risk management, it should not be assumed that this aligns with either best practice or members best interests in each instance. Rather APRA should have regard to the size, structure and nature of operations of each fund in coming to a view.

AIST submits that that the following skills-related recommendations we made to the 2019 APRA Capability Review remain relevant today:

- APRA provide additional skilled staff resources in order to meet its prudential supervision responsibilities in light of the increased size and complexity of the superannuation sector.
- APRA establish a two-way secondment program across the superannuation industry to support understanding of industry and address critical skill gaps.
- APRA undertake a skills gap assessment to support future recruitment, with reference to the structure and operation of the superannuation sector and future operating environment in financial services.
- APRA supplement the skills of its highly-qualified staff with superannuation-industry specific training.

Transition to data-driven supervision should supplement, not replace, existing supervision

As APRA is in receipt of more data about products, super funds, industry segments and the industry as a whole, this data is being increasingly used in its supervisory efforts. While a data-driven approach is appropriate, it needs to be supported by increased analytical skills so that the significance and impact of the data is understood and properly progressed. It also needs to be supported by a high-level understanding of the superannuation system and its operation, especially supervisory staff.

The use of data should supplement, not substitute, existing forms of prudential supervision, especially the use of supervisory teams that have a close understanding of the supervised entity and of superannuation.

At a practical level, this means that supervisors responding to data-driven insights should have a clear and focused view of the issue and should not adopt a scattergun approach. It should also mean that data findings used to instigate further enquiries should clearly articulate the purpose of the enquiry to assist both the super fund and APRA in addressing the issue.

4. *To what extent does APRA have the appropriate organisational capabilities (including, people, data, technology, and systems) for detecting prudential risks, prioritising issues, and conducting its supervisory activities to achieve the right outcomes?*

Our responses to other questions has already addressed this question. In summary:

- Ongoing skill gaps, especially in relation to superannuation knowledge should be addressed as a priority

- APRA is a relatively small government agency, and its lack of scale and capability in areas such as information technology and data should be ameliorated by leveraging off the capabilities of larger, better resourced Government bodies such as the ATO.
- APRA's restructure has improved APRA's focus on the overall performance of the superannuation system for members, and better reflects the increased legislative focus on member outcomes and best interests.

5. What steps has APRA taken to effectively reduce the regulatory impost of its supervisory activities? How could APRA improve?

At an industry level, APRA consultations on regulatory change including the cost and impact on RSEs have improved significantly in recent years. In areas such as Superannuation Data Transformation and Investment Governance, APRA has engaged with industry at an early stage, established comprehensive consultation processes, and been accessible for industry forums.

There remain significant issues in each of these areas – particularly in relation to the scale and investment needed to implement changes to APRA data reporting – but APRA has consistently taken positive steps to try and ameliorate them.

However, APRA should address issues of regulatory duplication, discrepancies and overload though better scheduling and co-ordination of regulatory change activities, and by better co-ordination with other Government agencies.

While APRA annually publishes strategic priorities and key activities, reviews and new prudential standards and practice guides could be better sequenced and co-ordinated, with the reduction of regulatory imposts being explicitly identified as a principle to be followed.

Prudential practice guides are often released concurrently or shortly after the final prudential standards are drafted. This can result in industry being given insufficient time to appreciate and respond to important aspects of prudential practice guides.

The sequencing of the Modernising Prudential Architecture project alongside the review of SPS 530 Investment Governance, and the commencement of SPS 530 on 1 January 2023 during the midst of consultations on a revised SPG 530 Investment Governance (and also incorporating SPG 531 Valuations) is an example of confusing sequencing, that results in uncertainty amongst super funds about meeting APRA's expectations. There are considerable interdependencies between each element, and it is difficult to assess the implications of each element when related elements are also in flux.

APRA has been very accessible and consultative about each element, but it would have been much clearer had the sequence of these three elements been better managed at the outset.

Better and early co-ordination between Government agencies is needed

In relation to inter-agency co-ordination, to an external observer, APRA does not appear to have the optimal communication and information sharing arrangements with other government agencies. This can result in double reporting by super funds to ASIC and duplicated consultations on related matters.

For example, there are many common elements to Member Outcomes Assessment by super funds (and oversighted by APRA), and the steps they need to take to meet their Design and Distribution Obligations (oversighted by ASIC). However, despite this being pointed out by AIST and others prior to the implementation of both reforms, the level of co-ordination between APRA and ASIC about these appeared to be limited, and somewhat after-the-event.

An AIST member fund has also noted:

Occasionally we have found that when we raise the issue of duplicate reporting or regulation APRA has been reluctant to pursue the issue with its peer, rather, it leaves it to individual entities to raise issues directly.

Finally, and as mentioned earlier, funds report positive and constructive relationships with their supervisory teams, but that supervisory activities in some cases are made more difficult than they should by a lack of superannuation knowledge and practical operational experience; high volumes of unstructured electronic communications and requests; and by limited opportunity for face-to-face communications (including regular liaison meetings).

APRA could improve by implementing the skills gap recommendations made by AIST earlier in this submission.

Post-implementation reviews of regulatory change may reduce the regulatory impost of supervisory activities

The creation of the Financial Regulator Assessment Authority is resulting in increasing scrutiny of financial service regulators including APRA. While this is welcomed and fulfills a recommendation of the Financial System Inquiry, other FSI recommendations about the regulatory system are still to be implemented.

While some of these are a matter for Government, the recommendations for regulators to adhere to minimum implementation lead times and conduct post-implementation reviews of major regulatory changes more frequently monitor impacts are relevant to APRA. The inquiry suggested that improved regulatory processes could reduce industry costs and lead to better outcomes.

While the legislative change programs of successive governments has made this difficult, APRA does generally provide reasonable implementation lead times (although with the sequencing issues that are raised later in this submission), but does not often conduct public post-implementation reviews that would give RSEs the opportunity to identify changes that could improve supervisory efficiencies.

AIST recommend that APRA hold post-implementation reviews and consult with the superannuation industry on all significant regulatory changes, and that these reviews include consideration of regulatory impost and the efficiency of supervisory activities.

> 6. *How has APRA's supervisory activities and the nature of its relationship with stakeholders changed following recent independent inquiries and reviews?*

APRA reviewed its approach to enforcement following the Financial Services Royal Commission and undertook to strengthening information technology, risk and data analytics, enterprise planning, and supervisory and policy capabilities.

While this is welcomed, APRA remains a relatively small government agency, and its lack of scale will continue to constrain its capabilities in areas such as information technology.

AIST supports steps taken by APRA to develop improved data collections to support early risk identification; improve data sharing with other Government agencies; and reduce the long-term reporting burden on industry. This should include leveraging off the data and IT capabilities of large, more resourced Government bodies such as the ATO.

Assessment of the effectiveness and capability of APRA's resolution function in superannuation

APRA's resolution function can relate to either the failure of a regulated institution, or a crisis in the financial system.

AIST's discussions with our member funds revealed little direct knowledge or experience of APRA's entity-level resolution function, although many funds were involved in recent consultations about APRA moves to strengthen crisis preparedness in banking, insurance and superannuation

APRA's industry-level resolution function is better understood

AIST was involved in consultations with APRA about proposed new prudential standards to strengthen the preparedness of regulated entities to respond to future financial crises (CPS 190 Financial Contingency Planning and CPS 900 Resolution Planning).

In our submission, AIST noted that the application of the proposed crisis preparedness standards within the superannuation sector is limited to the trustees / RSE licensees of funds and not the funds themselves. This distinction means that profit-to-member super funds are by-and-large already compliant with the new requirements proposed. Guidance supporting the standards will need to address the specifics of how the standards will operate in sectors with distinctive business models, not just take a blanket approach to the financial services industry more broadly.

As a result of this consultation, APRA's *industry-level* resolution function plans have been communicated to and are consequently more widely understood by super funds.

APRA's entity level resolution function needs to be better communicated

However, this is not the case in relation to APRA's *entity level* resolution function.

While the failure of an APRA-regulated superannuation fund is very rare, it is recognised that one of APRA's core functions is to ensure it can be exited from the industry in an orderly manner, with little or no loss to members, and minimal disruption to the financial system.

It is unclear how important it is for individual RSEs to be aware of end-stage resolution processes in the normal course of business. It is however very importance for RSEs to understand their level of supervision risk as assessed by APRA.

The 2019 Capability Review recommended APRA embed and reinforce its increasing focus on member outcomes and continue to ensure that trustees prudently manage member funds by taking a number of steps. These included the development of a superannuation performance tool to replace APRA's Probability and Impact Rating System (PAIRS) and the Supervisory Oversight and Response System (SOARS).

APRA introduced a new model to assess risk and determine supervisory intensity, called the Supervision Risk and Intensity (SRI) model. Its design features elevated non-financial risks whilst preserving the importance of financial resilience. For example, the model includes specific consideration of Governance, Culture, Remuneration and Accountability.

The SRI model operates in tandem with data collection, member outcomes, heatmap and performance assessment.

The SRI model is aligned with supervision, and results of SRI assessment can be a valuable for RSEs as well as to APRA. SRI scores are confidential and cannot be disclosed by funds receiving their own score.

AIST recommend that APRA:

- establish an annual program of confirmation and discussion with each super fund about their SRI score, with a view to more effectively and explicitly addressing supervisory risk issues.

- publish further details of APRA's proposed resolution framework, including relationship to other supervisory activities and SRI.

For further information regarding our submission, please contact David Haynes, AIST Senior Policy Manager at dhaynes@aist.asn.au

Yours sincerely,

Eva Scheerlinck

Chief Executive Officer