Superannuation – APRAs new target

A summary of the regulator's recent focus on the industry

Introduction

The initiation of the Financial Services Royal Commission in 2017 and the APRA Inquiry into the CBA in 2018 started an enormous improvement in risk and compliance management practices within the financial services industry in Australia. With the focus of these primarily being on banking and credit services, banks were the first to undertake a wave of uplift activity, with insurers following soon after.

That wave of uplift activity has been less pronounced in the Superannuation industry, largely because public incidents of misconduct have focused on banks and insurers. That is now changing quickly, with public discussion about the role of Superannuation driving APRA to take a forceful approach to supervision of the industry.

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APRA's Approach

This is best illustrated by unprecedented statements from APRA that it expects smaller funds to merge, and its use of Enforceable Undertakings to force these mergers in the case of poorly governed funds.

In November 2021, APRA imposed licence conditions on the Trustee of the Energy Industries Superannuation Scheme (EISS) which required it to implement a strategy to merge with a larger, better performing fund. This was repeated with Christian Super a month later, who were subject to the same licence condition and subsequently merged with Australian Ethical Super in July 2022.

The finality of these conditions, which effectively terminate these funds, is extremely forceful in comparison to APRAs typically more consultative supervisory approach.

Performance Tests

APRA also released the results of its second MySuper performance test (in August 2022), which assesses employer-default funds against performance benchmarks. 4% of funds failed this test, after 16%

failed the inaugural test last year. Funds which fail the test have been required to write to their members explicitly identifying the underperformance. This test will eventually be expanded to all Superannuation funds and non-My Super products.

The performance tests have received criticism for using a notional return benchmark and balance which may misrepresent fees, a singular return timeframe and a black and white approach to underperformance. The use of a single financial metric does not give consideration to, for example, fund ethical mandates. In addition, funds that fail the test twice in a row will be prohibited from accepting new members. This raises a valid concern that funds which fail the test are incentivised to increase the investment risk in their portfolios to avoid failing a second time.

Outlook

Regulatory obligations surrounding superannuation are also increasing. In the past year, APRA has incrementally increased data reporting requirements in Superannuation and updated obligations relating to investment governance. In addition, remuneration obligations under CPS 511 will apply to Superannuation licensees with phased effect from 1 July 2023. APRA is also consulting the industry on changes to obligations regarding strategic planning and member outcomes and has signalled an increasing interest in operational risk management and vendor risk management at Trustees.

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