

Prudential Regulation of Superannuation Entities

Australian Prudential Regulation Authority

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ISSN 1036–7632 (Print)

ISSN 2203–0352 (Online)

ISBN 978-1-76033-201-3 (Print)

ISBN 978-1-76033-202-0 (Online)

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Canberra ACT
23 November 2016

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Australian Prudential Regulation Authority titled *Prudential Regulation of Superannuation Entities*. The audit was conducted in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit to the Parliament.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's website—<http://www.anao.gov.au>.

Yours sincerely



Grant Hehir
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

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Summary and recommendations

Background

1. The Australian Prudential Regulation Authority (APRA) is the prudential regulator of Australia's financial services industry. APRA supervises financial institutions across the deposit-taking, insurance and superannuation industries. APRA supervises a wide range of superannuation funds under the *Superannuation Industry (Supervision) Act 1993*.¹ Superannuation entities regulated by APRA are called registrable superannuation entities and include superannuation funds, approved deposit funds, pooled superannuation trusts and small APRA funds.² In June 2015 there were 155 licensed trustees³ responsible for 242 registrable superannuation entities with more than four members.

2. As at 30 June 2015, APRA-regulated funds controlled \$1.2 trillion in superannuation industry assets. APRA's role in undertaking superannuation regulatory activities is to ensure that superannuation entities manage risk prudently in order to meet the financial promises made to superannuation beneficiaries—that is, to protect the financial interests of superannuation fund members.

Audit objective and criteria

3. The objective of the audit was to assess the effectiveness of APRA's processes for the prudential regulation of superannuation entities.

4. To form a conclusion on the audit objective the following high-level criteria were adopted:

- prudential and reporting standards are determined in accordance with legislation, in consultation with stakeholders, and having regard to risk;
- effective arrangements exist for the processing and consideration of superannuation entity licence applications, and registration of entities;
- risks to the interests of beneficiaries are identified, and arrangements are in place to guide APRA's superannuation prudential regulation activities; and
- APRA effectively supervises superannuation entities to monitor their ability to meet the reasonable expectations of beneficiaries, and takes action where issues are identified.

1 Self-managed superannuation funds and public sector superannuation funds are exempt from APRA supervision.

2 Superannuation funds include public and non-public offer funds and eligible roll-over funds; an approved deposit fund can receive, hold and invest certain types of rollover funds until such funds are withdrawn; a pooled superannuation trust is a trust in which only assets of superannuation funds, approved deposit funds and other pooled superannuation trusts can be invested; and a small APRA fund is a superannuation fund managed by a licensed trustee and regulated by APRA but has fewer than five members. This audit did not examine small APRA funds.

3 A registrable superannuation entity licensee is a constitutional corporation, body corporate, or group of individual trustees, that holds a registrable superannuation entity licence granted by APRA under section 29D of the *Superannuation Industry (Supervision) Act 1993*.

Conclusion

5. APRA's risk management arrangements and supervision framework provide a sound basis for supervising the superannuation industry, which has had few entity failures in recent years. APRA also has effective arrangements in place for setting prudential and reporting standards, providing guidance to assist superannuation entities in complying with the requirements of the standards, and processing licensing and registration applications for superannuation entities. However, there is scope for APRA to improve its management of supervision activities, to support superannuation entities to better manage prudential risks on behalf of beneficiaries. In recent years, similar superannuation entities have received varying levels of supervision and higher risk entities have not consistently been subject to more intense supervision. Further, many of the activities reviewed by the ANAO were late and not recorded in the issues and document management systems, and APRA has limited external reporting of its supervision of the superannuation industry.

Supporting findings

Standard setting

6. APRA determines prudential standards and reporting standards in accordance with the relevant requirements under the *Superannuation Industry (Supervision) Act 1993*, the *Financial Sector (Collection of Data) Act 2001*, the *Superannuation Industry (Supervision) Regulations 1994* and the *Corporations Act 2001*. It also has effective internal policy development processes for the development of prudential standards and reporting standards.

7. APRA's policy initiatives in relation to prudential and reporting standards are informed by government policy directions and relevant intelligence, and it undertakes detailed regulatory impact assessments and cost-benefit analyses of its proposed policy initiatives. In developing standards, APRA seeks to achieve an appropriate balance between the benefits of financial safety for superannuation beneficiaries and considerations of efficiency, contestability, competition and competitive neutrality. APRA's standards development process complies with the requirements of the Office of Best Practice Regulation.

8. APRA consults effectively with internal and external stakeholders in the development of prudential and reporting standards. It also provides a range of guidance to support superannuation entities to comply with prudential and reporting standards. The guidance is clear and consistent with the relevant standards and APRA's legislative powers.

9. APRA has undertaken reviews and amendments of its prudential standards, reporting standards and prudential practice guides when industry issues or risks were identified or there were changes in government policy. However, APRA has not yet established a review program or scheduled a point-in-time review of the effectiveness and appropriateness of its suite of standards and prudential practice guides since their implementation in 2013. The timeframe for undertaking such a review is approaching given that APRA specified that they would be reviewed three to four years after their implementation.

Licensing and registration

10. APRA provides appropriate forms and guidance to support the licensing and registration of superannuation entities. The application forms are aligned with legislative requirements for the licensing and registration of registrable superannuation entities, and support applicants to provide relevant information in their application. APRA also publishes suitable guidance material on its website to assist entities with the application process. Minor improvements could be made to the licence application form and related guidance material.

11. APRA assesses licence and registration applications in accordance with the requirements of the *Superannuation Industry (Supervision) Act 1993* and superannuation prudential standards. The assessment of the applications is consistent with APRA's internal guidance and procedures for licensing and registration. APRA's decisions about licence and registration applications are documented, timely and subject to appropriate assurance processes.

Risk management arrangements and supervision framework

12. The design of APRA's risk management arrangements supports its supervision of the superannuation industry, including a detailed risk assessment system for individual superannuation entities. However, there is scope to improve the implementation of these arrangements. In particular, APRA can more consistently undertake individual superannuation entity risk assessments and better manage identified industry-wide superannuation risks.

13. APRA's supervision framework promotes a proportionate approach to undertaking supervision activities. It encompasses a minimum baseline level of activity determined by entity asset size (impact) and additional activity determined by assessed entity risk and size (supervisory stance). Within this framework, there were a number of instances where supervision had not been appropriately tailored to risk, including:

- entities with the same supervision stance were subject to varying levels of supervision activity;
- activities were sometimes undertaken in accordance with asset size rather than supervisory stance; and
- some entities were not subject to the baseline level of supervision activity.

Supervision activities and reporting

14. While undertaking a substantial number of supervisory activities that have made many proposals for improved performance by superannuation trustees, APRA has not managed supervisory activities for the superannuation industry as effectively as it could have. The ANAO's analysis of 50 electronic trustee files found that only four per cent of the actions proposed in prudential reviews were recorded in APRA's issues management system, which has limited APRA's ability to monitor entities' responses to outcomes and analyse trends from this information in its industry risk analysis. Further, more than half of the superannuation supervision activities completed by APRA from 1 July 2013 to 24 March 2016 were overdue and a large proportion of prudential reviews examined by the ANAO were not recorded electronically in line with internal guidance. While few in number, APRA has not routinely reviewed its supervision of entities subject to enforcement action to identify opportunities to improve its broader supervision approaches.

15. APRA does not have a quality assurance framework. It does not undertake independent reviews of supervisors' work such as financial and qualitative analysis or interactions with entities.

16. There is limited oversight by APRA's Executive of the implementation of supervision activities, and APRA can better specify its key performance indicators to measure the timeliness, quality and implementation of supervision activities. While APRA reports stakeholder survey results by industry, it does not report any other disaggregated performance information by industry in its annual reports. Consequently, there is limited performance information available externally to enable stakeholders to form a view as to whether APRA is effectively supervising the superannuation industry.

Recommendations

Recommendation No. 1
Paragraph 4.28 To promote proportionate, risk-based supervision of superannuation entities, APRA implements measures to provide greater consistency in the supervision of entities with similar risk profiles.

APRA's response: *Agreed.*

Recommendation No. 2
Paragraph 5.14 To support effective and efficient administrative processes, APRA:

- (a) improves the recording of actions made in prudential reviews of superannuation trustees and uses the information in considering industry-wide risks and developing prudential guidance for trustees; and
- (b) introduces an electronic record keeping approach for its supervisory activities in accordance with the Australian Government Digital Transition Policy.

APRA's response: *Agreed.*

Recommendation No. 3
Paragraph 5.30 APRA implements a quality assurance framework that includes independent reviews of the work undertaken by supervisors.

APRA's response: *Agreed.*

Recommendation No. 4
Paragraph 5.40 APRA's public reporting provides a meaningful representation of whether APRA is achieving its purposes in supervising the superannuation industry.

APRA's response: *Agreed.*

Summary of entity response

17. APRA's summary response to the report is provided below, while its full response is in Appendix 1.

APRA is pleased to note the ANAO's conclusions that:

- APRA has effective arrangements in place for setting prudential and reporting standards and providing guidance to assist superannuation entities to comply with the requirements of the standards;
- APRA has effective arrangements in place for processing licensing and registration applications for superannuation entities; and
- APRA's risk management arrangements and supervision framework provide a sound basis for supervising the superannuation industry.

The Report contains four recommendations and a number of suggestions that, when implemented, will enhance the quality of APRA's supervision of superannuation, as well as the other areas of the financial sector for which APRA has responsibility. Importantly, the recommendations and suggestions align with initiatives that APRA has already identified for action in our 2016-2020 Corporate Plan.

Our letter of reply provides a fuller response to some of the issues of detail contained within the Report.

Audit Findings

1. Background

Australian Prudential Regulation Authority

1.1 The Australian Prudential Regulation Authority (APRA) is a Commonwealth statutory authority in the Treasury portfolio. APRA was established on 1 July 1998 by the *Australian Prudential Regulation Authority Act 1998*, and sources its powers from this and other industry specific legislation including: the *Banking Act 1959*, the *Insurance Act 1973*, the *Life Insurance Act 1995*, and the *Superannuation Industry (Supervision) Act 1993*.

1.2 As the prudential regulator of Australia's financial services industry, APRA is responsible for prudential supervision of individual financial institutions and for promoting financial system stability in Australia. In doing so, APRA assesses whether entities are at risk of failing to fulfil their obligations to beneficiaries by monitoring the financial position and governance of institutions. The entities that APRA regulates include:

- authorised deposit-taking institutions (banks, credit unions and building societies);
- general insurers, life insurers, private health insurers and friendly societies; and
- superannuation funds (excluding self-managed superannuation funds⁴ and exempt Public Sector Superannuation Schemes⁵).

1.3 APRA's approach to regulation is based on the premise that the primary responsibility for financial soundness and prudent risk management rests with an entity's own board of directors and senior management. Accordingly, APRA's role is to promote prudent behaviour through a prudential framework to ensure that a regulated entity takes reasonable risks and is well managed. In doing so, APRA seeks a low incidence of failure as opposed to zero failure.⁶

1.4 In 2016–17, APRA's total appropriation was \$664.1 million—\$532.7 million administered and \$131.3 million departmental expenses. APRA's estimated average staffing level for 2016–17 is 605 FTE, and approximately 77 of those are non-Executive staff directly responsible for supervising superannuation entities.⁷ APRA has industry cost recovery arrangements for its supervision activities and some licensing and registration activities.

Superannuation industry

1.5 As at 30 June 2015, Australian superannuation funds controlled total assets of \$2.0 trillion.⁸ Superannuation funds are classified as corporate, industry, public sector, retail, or small. Table 1.1 provides an overview of each of these and their relative size within the industry.

4 Self-managed superannuation funds are regulated by the Australian Taxation Office. In these funds, the members are also the trustees and are responsible for compliance with superannuation and tax laws.

5 Exempt Public Sector Superannuation Schemes are the responsibility of the relevant federal, state or territory government and are exempt from prudential supervision unless they have opted to be supervised by APRA. These schemes are listed in the Superannuation Industry (Supervision) Regulations 1994, schedule 1AA.

6 Australian Prudential Regulation Authority, *APRA Statement of Intent*, APRA, 2014.

7 Some of these staff also supervise other industries.

8 Australian Prudential Regulation Authority, *Annual Superannuation Bulletin*, APRA, 2016.

Table 1.1: Superannuation industry as at 30 June 2015

Fund Type	Description	Number of entities	Total Assets (\$ billion)	Proportion of industry assets (%)
Corporate	Sponsored by a single or group of (usually) related employers	34	53.9	2.7
Industry	Members from a range of employers across a single industry or group of related industries	43	434.1	21.5
Public sector ^a	The sponsoring agency or business enterprise is majority government owned	38	350.6	17.3
Retail	Sell policies to the public on a commercial basis	146	536.5	26.5
Small	Self-managed superannuation funds ^b	556 998	589.9	29.2
	Single-member approved deposit funds and small APRA funds	2 288	2.1	0.1
Balance of life office statutory funds ^c			56.1	2.7
Total		559 547	2 023.1	100.0

Note a: Exempt Public Sector Superannuation Schemes make up \$131.1 billion of public sector superannuation funds.

Note b: Self-managed superannuation funds are not regulated by APRA.

Note c: These are regulated under the *Life Insurance Act 1995*, not as superannuation entities.

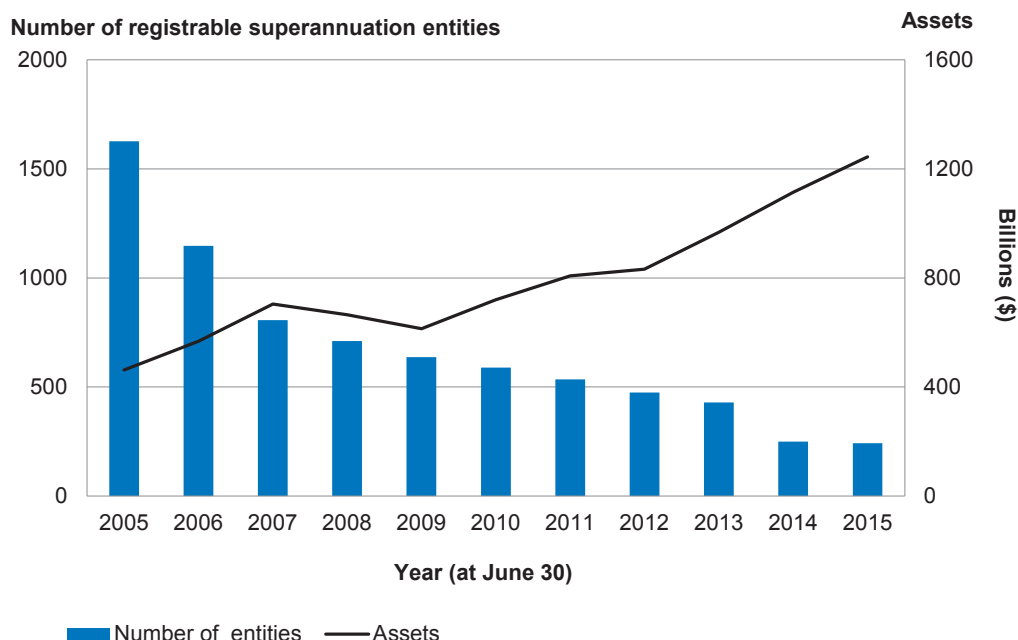
Source: Australian Prudential Regulation Authority, *Annual Superannuation Bulletin*, APRA, 2016.

1.6 Superannuation entities regulated by APRA are called registrable superannuation entities and include superannuation funds, approved deposit funds, pooled superannuation trusts and small APRA funds.⁹ As at 30 June 2015, APRA-regulated funds controlled \$1.2 trillion in superannuation industry assets.

1.7 In June 2015 there were 155 licensed trustees¹⁰ responsible for 242 registrable superannuation entities with more than four members. In 2014–15, the number of trustees and the number of registrable superannuation entities with more than four members declined by 14 and seven, respectively. Figure 1.1 illustrates the industry consolidation over the past decade, which APRA attributes to regulatory reform and a search for economies of scale. Over the same period, assets have more than doubled.

9 Superannuation funds include public and non-public offer funds and eligible roll-over funds; an approved deposit fund can receive, hold and invest certain types of rollover funds until such funds are withdrawn; a pooled superannuation trust is a trust in which only assets of superannuation funds, approved deposit funds and other pooled superannuation trusts can be invested; and a small APRA fund is a superannuation fund managed by a licensed trustee and regulated by APRA that has fewer than five members. This audit did not examine small APRA funds.

10 A registrable superannuation entity licensee is a constitutional corporation, body corporate, or group of individual trustees, that holds a registrable superannuation entity licence granted by APRA under section 29D of the *Superannuation Industry (Supervision) Act 1993*.

Figure 1.1: Number of APRA-regulated superannuation entities and their total assets

Note: Number of APRA-regulated entities excludes small APRA funds.

Source: ANAO analysis.

1.8 In 2011 and 2012, the Government introduced the Stronger Super reforms as a response to the 2010 Super System Review¹¹ into the governance, efficiency, structure and operation of Australia's superannuation system.¹² The key elements of the reforms were: the introduction of MySuper, as a simple and cost-effective default superannuation service in order to increase competition and decrease costs; a set of reforms, called SuperStream, aimed at improving the administration of superannuation entities; a range of measures with the objective of improving the governance and integrity of the superannuation system; and reforms to increase the integrity of self-managed superannuation funds. As part of the reforms, legislation was amended to allow APRA to create prudential standards—which APRA introduced in July 2013—that set out binding requirements that must be complied with by superannuation entities. APRA also introduced reporting standards to incorporate enhanced data collection and data publication requirements related to the Stronger Super reforms.

1.9 A key challenge facing the superannuation industry is the changing demographic of the Australian population. The change has resulted in a large number of members transitioning from the accumulation phase to the post-retirement phase, which is evidenced by benefit payments rising faster than contributions. This poses ongoing liquidity and investment risks for trustees in meeting their obligations to beneficiaries.

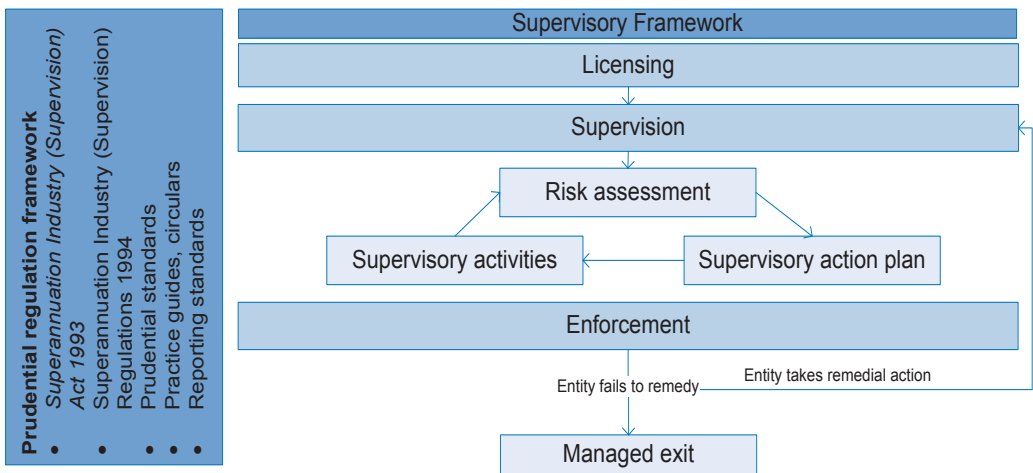
11 Announced in May 2009 by the Minister for Superannuation and Corporate Law.

12 J Cooper, *Super System Review* [Internet], The Treasury, 2010, available from <<http://www.treasury.gov.au/ConsultationsandReviews/Reviews/2009/Super-System-Review>> [accessed 12 July 2016].

APRA’s regulation of the superannuation industry

1.10 APRA’s mission has two key aspects: to establish prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by institutions are met within a stable, efficient and competitive financial system; and to enforce those standards and practices.¹³ The first of these aspects is delivered through the prudential framework which is different for each industry that APRA regulates. The second is through APRA’s supervisory framework which is primarily the same across all regulated industries. Figure 1.2 provides an overview of the frameworks and how they relate to each other.

Figure 1.2: APRA’s regulatory responsibilities



Source: ANAO analysis of APRA information.

13 Australia Prudential Regulation Authority, *The APRA Supervision Blueprint* [Internet], APRA, 2015, available from < <http://www.apra.gov.au/AboutAPRA/Documents/APRA-Supervision-Blueprint-FINAL.pdf> > [accessed September 2016].

Superannuation prudential framework

1.11 The prudential framework for the superannuation industry is outlined in Figure 1.3.

Figure 1.3: Prudential framework for the superannuation industry

Primary legislation	The <i>Superannuation Industry (Supervision) Act 1993</i> provides high-level obligations, definitions and enforcement powers including APRA's power to set prudential standards for regulated superannuation funds and the trustees of those funds. ^a
Subordinate legislation	The Superannuation Industry (Supervision) Regulations 1994 and prudential standards that APRA introduces under its authority from the <i>Superannuation Industry (Supervision) Act 1993</i> . There are currently 13 prudential standards for the superannuation industry.
Other guidance	APRA's prudential practice guides, circulars, guidance notes and other guidance which support APRA's prudential standards. Unlike the primary and subordinate legislation, these are not enforceable.

Note a: *Superannuation Industry (Supervision) Act 1993*, s. 34C.

Source: Australian Prudential Regulation Authority, *Insight Issue One*, APRA, 2012; and Australian Prudential Regulation Authority, *Superannuation Prudential Framework* [Internet], APRA, available from <<http://www.apra.gov.au/Super/PrudentialFramework/Pages/superannuation-prudential-framework.aspx>> [accessed 12 July 2016].

1.12 APRA has two divisions that are primarily responsible for supervising the superannuation industry:

- the Diversified Institutions Division supervises Australia's large and complex financial groups; and
- the Specialised Institutions Division supervises predominantly standalone licensed entities, for example regional banks and credit unions, and also superannuation entities.

These divisions are supported by a number of teams including the Supervisory Framework team, Industry Analysis team, Policy and Advice Division and the Supervisory Support Division.

APRA's supervisory framework

1.13 The supervisory framework through which APRA undertakes its prudential regulation has three key stages: licensing and registration; supervision; and enforcement.

Licensing and registration

1.14 APRA is responsible for licensing trustees of registrable superannuation entities, and registering these entities to help ensure that only those that meet the prudential requirements, and have the ability to meet their financial promises, are able to operate in Australia.

1.15 After a trustee has received a registrable superannuation entity licence, it may apply to register one or more registrable superannuation entities. Upon receipt of licence and registration, the licensee and entity are required to comply with licensee law and other ongoing requirements—as defined in the *Superannuation Industry (Supervision) Act 1993*.¹⁴

¹⁴ Registrable superannuation entity licensee law is defined in section 10 of the *Superannuation Industry (Supervision) 1993 Act* and, in addition to the legislation mentioned in Figure 1.3, includes: the *Financial Sector (Collection of Data) Act 2001*; the *Financial Institutions Supervisory Levies Collection Act 1998*; and certain provisions of the *Corporations Act 2001*.

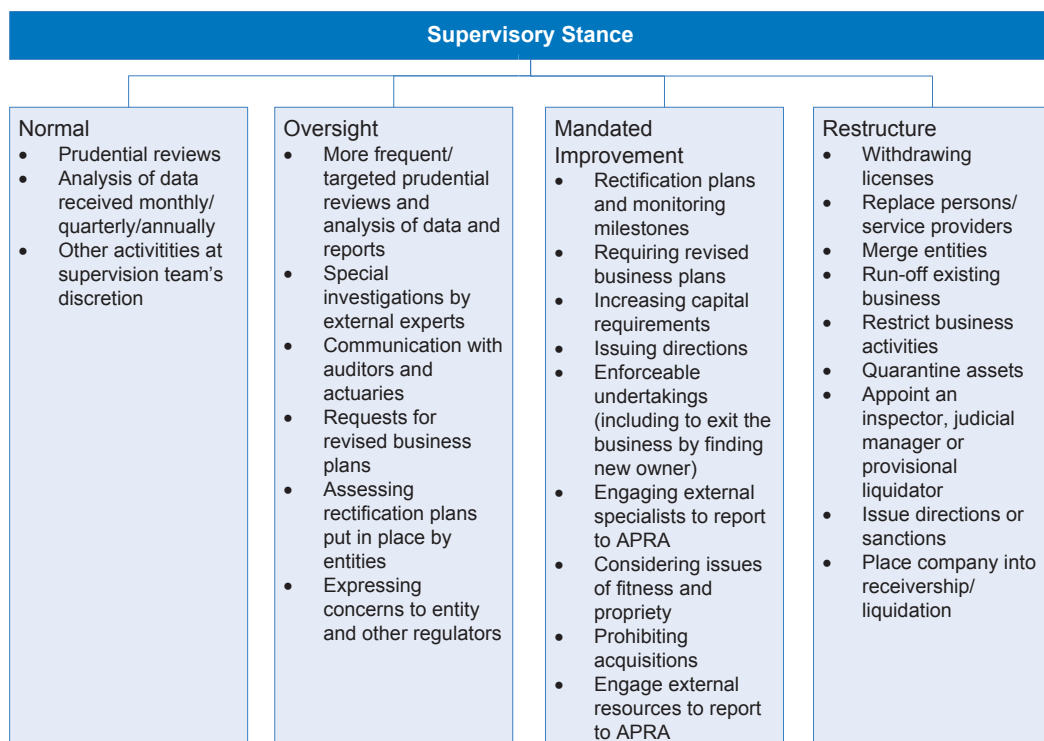
Supervision

1.16 Licensed entities are subject to ongoing supervision by APRA to: identify key risks that the entities are exposed to; ensure entities are adequately measuring, managing and monitoring risks; and assess the adequacy of their access to financial resources to withstand potential losses. *The APRA Supervision Blueprint*¹⁵ establishes the strategic direction of APRA's supervisory framework, which encompasses all activities, supporting procedures, processes, systems and guidelines that are used by supervisors in forming risk assessments and supervision strategies.

1.17 The two main elements of APRA's supervision model are the Probability and Impact Rating System and the Supervisory Oversight and Response System supervisory tools, created in 2002:

- the Probability and Impact Rating System assesses how likely an entity is to fail and the potential impact of failure. Applying the system, APRA develops probability and impact index ratings that together create the supervisory attention index rating, which assists APRA to determine the size of its supervisory task.
- the Supervisory Oversight and Response System is used to determine supervisory stances derived from the Probability and Impact Rating System. Once the supervisory stances have been determined, APRA supervisors develop supervisory action plans for each entity. The supervisory action plans take into account the key risks and issues from the Probability and Impact Rating System process and set out the key supervisory activities, as outlined in Figure 1.4, to be undertaken over the following 12 to 24 months to address the issues.

15 Australian Prudential Regulation Authority, *The APRA Supervision Blueprint* [Internet], APRA, 2015, available from <<http://www.apra.gov.au/AboutAPRA/Documents/APRA-Supervision-Blueprint-FINAL.pdf>> [accessed 12 July 2016].

Figure 1.4: APRA's supervisory activities

Note: These are examples of actions that can be undertaken and are not mandatory.

Source: Australian Prudential Regulation Authority, *Supervisory Oversight and Response System* [Internet], APRA, 2012, available from <<http://www.apra.gov.au/CrossIndustry/Documents/SOARS-062012-External-version.pdf>> [accessed 12 July 2016].

1.18 As at 31 March 2016, of the 138 trustees subject to supervisory activity: 68 had a normal stance; 66 had an oversight stance; and three were categorised as mandated improvement.¹⁶

1.19 Since 2009 there has only been one incidence of failure of an APRA-regulated superannuation trustee. Trio Capital, a registrable superannuation entity trustee, failed in 2009—a result of approximately \$150 million of related-party investments lost or unrecovered. A review¹⁷ of the incident by the Treasury in 2013 found that APRA carried out its responsibilities appropriately. Investigation by APRA into the failure revealed that the key factors leading to the losses were: inadequate investment governance; failure to adequately manage conflicts of interest from dealings with related parties; and failure to have adequate controls to mitigate fraud-related investment risk.

Enforcement

1.20 In cases where APRA has serious prudential concerns about an entity it can intervene and take remedial enforcement action. As seen in Figure 1.4, APRA's enforcement powers include

¹⁶ One entity did not have a stance. APRA advised that this was due to an internal reporting error.

¹⁷ The Treasury, *Review of the Trio Capital fraud and assessment of the regulatory framework*, Treasury, 2013.

enforceable undertakings, placing restrictions on business operations, and placing an entity into receivership or liquidation. Situations where enforcement action is required usually result in two possible outcomes: the entity will take sufficient action to reduce the risks and return to a high level of supervision; or APRA will help the entity to make a managed exit from the industry. Since 2009, APRA has commenced enforcement action towards two entities as of March 2016.

Audit approach

Audit objective, criteria and scope

1.21 The objective of the audit was to assess the effectiveness of APRA's processes for the prudential regulation of superannuation entities.

1.22 To form a conclusion on the audit objective the following high-level criteria were adopted:

- prudential and reporting standards are determined in accordance with legislation, in consultation with stakeholders, and having regard to risk;
- effective arrangements exist for the processing and consideration of superannuation entity licence applications, and registration of entities;
- risks to the interests of beneficiaries are identified, and arrangements are in place to guide APRA's superannuation prudential regulation activities; and
- APRA effectively supervises superannuation entities to monitor their ability to meet the reasonable expectations of beneficiaries, and takes action where issues are identified.

1.23 The audit focussed on APRA's performance of its superannuation regulation responsibilities from 2013 to mid-2016, with historical context and comparisons undertaken as appropriate. The audit scope did not include: the variation or cancellation of licences; winding up of funds; supervision of small APRA funds, MySuper authorisation process and eligible roll-over funds.

Audit methodology

1.24 The major audit tasks included: reviewing relevant documentation, systems and processes; analysing APRA data where available and appropriate; sampling licensee files to examine consistency with the supervisory framework; and interviewing relevant agency staff and stakeholders.

1.25 The audit was conducted in accordance with the ANAO Auditing Standards at a cost to the ANAO of approximately \$365 000.

2. Standard setting

Areas examined

The ANAO examined APRA's approach to setting prudential and reporting standards for superannuation. The ANAO assessed whether APRA develops standards in accordance with the relevant superannuation legislation, in consultation with stakeholders, and by having regard to risk and regulatory burden.

Conclusion

APRA has effective arrangements in place for setting prudential and reporting standards and providing guidance to assist superannuation entities to comply with the requirements of the standards.

Areas for improvement

The ANAO suggested that APRA undertake a review of the appropriateness and effectiveness of its standards and prudential practice guides as soon as practicable, and establishes a program to support the ongoing review of standards and prudential practice guides (paragraph 2.33).

Does APRA adhere to relevant legislation and guidance in determining prudential standards and reporting standards?

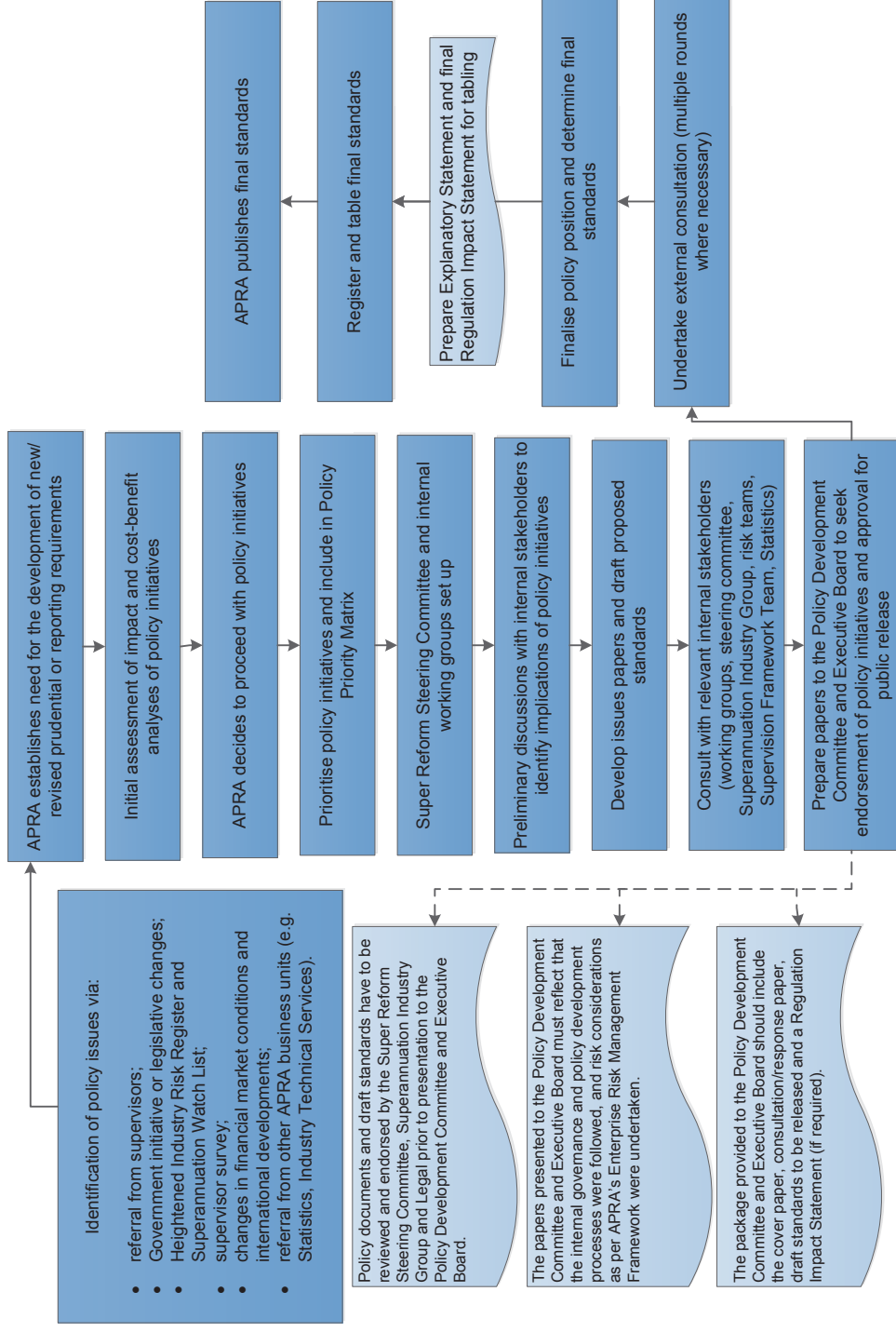
APRA determines prudential standards and reporting standards in accordance with the relevant requirements under the *Superannuation Industry (Supervision) Act 1993*, the *Financial Sector (Collection of Data) Act 2001*, the *Superannuation Industry (Supervision) Regulations 1994* and the *Corporations Act 2001*. It also has effective internal policy development processes for the development of prudential standards and reporting standards.

2.1 Superannuation prudential standards and reporting standards are legislative instruments within the meaning of the *Legislation Act 2003* and are therefore legally enforceable. All the final prudential standards and reporting standards made by APRA must be registered on the Federal Register of Legislation to ensure that they are legally enforceable and enable APRA to appropriately exercise its powers.

2.2 APRA's approach to developing prudential and reporting standards is illustrated in Figure 2.1. APRA has internal policies and procedures in place that provide a robust internal governance framework for developing these standards. For example, APRA's 'Red Guide'¹⁸ provides for: the mandatory process to meet the registration and tabling requirements for standards; and the mandatory review of the standards and their related policy documents by the Legal Group to ensure that they meet all legal requirements, reflect the policy intent and are consistent with APRA's legal powers.

¹⁸ The Red Guide comprises the *Developing effective prudential standards, reporting standards and prudential practice guides—Red Guide* and the accompanying Red Guide guidance.

Figure 2.1: APRA's processes for developing prudential and reporting standards



Source: ANAO analysis of APRA's internal discussion papers, meeting minutes and agendas.

Developing prudential standards

2.3 Prudential standards set out the requirements in relation to prudential matters that must be complied with by APRA-regulated entities in order to promote good governance, risk management and sound financial administration. APRA publishes all 13 superannuation prudential standards on its website.¹⁹

2.4 The ANAO's analysis of the superannuation prudential standards and their associated internal discussion papers found that APRA, when developing the superannuation prudential standards, had appropriately considered:

- relevant legislation including the *Superannuation Industry (Supervision) Act 1993*, the *Superannuation Industry (Supervision) Regulations 1994* and the *Corporations Act 2001*;
- the Stronger Super requirements;
- relevant elements of its existing guidance material including reclassifying some existing requirements as mandatory obligations in the superannuation prudential standards; and
- the requirements in prudential standards for its other regulated industries and cross-industry prudential standards.

Developing reporting standards

2.5 Section 13 of the *Financial Sector (Collection of Data) Act 2001* provides APRA with the power to issue reporting standards and collect financial information and statistical data from superannuation entities. APRA's reporting framework has been in place since 2004 and was revised in 2012 to support the implementation of superannuation prudential standards and the Stronger Super requirements.²⁰ APRA publishes all 40 superannuation reporting standards on its website.²¹

2.6 A reporting standard includes the corresponding reporting form and reporting instructions. Any change to the reporting form and instructions is also a change to the reporting standard itself. All components of the reporting standard are legally enforceable legislative instruments.

2.7 The ANAO's analysis confirmed that the reporting standards developed by APRA are based on the requirements under the relevant legislation including the *Financial Sector (Collection of Data) Act 2001*, the *Superannuation Industry (Supervision) Act 1993*, the *Superannuation Industry (Supervision) Regulations 1994* and the *Corporations Act 2001*. The reporting standards are determined to enable superannuation entities to report information to APRA to meet the statutory requirements.

19 The 13 superannuation prudential standards are accessible via <<http://www.apra.gov.au/Super/PrudentialFramework/Pages/superannuation-prudential-standards.aspx>> [accessed 7 September 2016].

20 Australian Prudential Regulation Authority, *Discussion Paper: Reporting standards for superannuation* [Internet], APRA, September 2012, available from <[http://www.apra.gov.au/Super/PrudentialFramework/Documents/Discussion-Paper-Reporting-standards-for-superannuation-\(Sep-2012\).pdf](http://www.apra.gov.au/Super/PrudentialFramework/Documents/Discussion-Paper-Reporting-standards-for-superannuation-(Sep-2012).pdf)> [accessed 12 July 2016].

21 The 40 superannuation reporting standards are accessible via <<http://www.apra.gov.au/Super/Pages/Superannuation-reporting-framework.aspx>> [accessed 7 September 2016].

Does APRA consider the impact of proposals on entities and take a balanced and risk-based approach to determining standards?

APRA's policy initiatives in relation to prudential and reporting standards are informed by government policy directions and relevant intelligence, and it undertakes detailed regulatory impact assessments and cost-benefit analyses of its proposed policy initiatives. In developing standards, APRA seeks to achieve an appropriate balance between the benefits of financial safety for superannuation beneficiaries and considerations of efficiency, contestability, competition and competitive neutrality. APRA's standards development process complies with the requirements of the Office of Best Practice Regulation.

2.8 The development of new policy or changes to existing policy may impose significant costs as well as lead to benefits to the superannuation industry. APRA must comply with external requirements and adhere to its internal governance framework in its consideration of the regulatory impact of proposed policies.

External requirements

2.9 As a Commonwealth regulator, APRA has to comply with best practice regulation requirements of the Office of Best Practice Regulation when developing prudential and reporting standards. Every regulatory policy proposal or substantive policy change must be accompanied by a Regulation Impact Statement.²² The Office of Best Practice Regulation assesses Regulation Impact Statements for compliance with best practice regulation requirements.

2.10 APRA's Red Guide provides for the mandatory preparation of a preliminary assessment of the impact of a proposed policy during the standards development process. The preliminary assessment is to be submitted to the Office of Best Practice Regulation for review to determine whether a Regulation Impact Statement is required. A Regulation Impact Statement is usually required unless the proposed policy initiative is minor or machinery in nature. The finalised Regulation Impact Statement will be assessed by the Office of Best Practice Regulation and published on the corresponding websites of the Office of Best Practice Regulation and APRA.

2.11 There were two Regulation Impact Statements prepared by APRA for its introduction of the superannuation prudential standards and reporting standards in 2012 and 2013 respectively.²³ The Office of Best Practice Regulation assessed both statements as compliant with its requirements of best practice regulation.²⁴

2.12 Pursuant to the *Legislation Act 2003*, the Federal Register of Legislation requires APRA to prepare an Explanatory Statement for each prudential and reporting standard prior to its

22 A Regulation Impact Statement has to outline the key steps taken in the policy development process, assess the impact of the regulatory proposal on different groups and the community as a whole, consider all viable options against the default position and include a detailed cost-benefit analysis of each option considered.

23 The Office of Best Practice Regulation determined that Regulation Impact Statements are not required for *Prudential Standard SPS 410 MySuper Transition* and *Prudential Standard SPS 450 Eligible Rollover Fund (ERF) Transition* released in 2013. Also, the revisions of reporting standards where the changes were minor do not require Regulation Impact Statements.

24 Office of Best Practice Regulation, *Australian Government Regulation Impact Statement status – by agency 2012–13* [Internet], OBPR, 2013, available from <https://ris.govspace.gov.au/files/2012/04/2012-13-master-TABLE-austgovtstatus_201305311.pdf> [accessed 21 July 2016].

registration and tabling. The ANAO analysed all Explanatory Statements prepared for the final registered standards and found that APRA had considered whether the standards are in accordance with the human rights and freedom provisions under the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Internal approach

2.13 APRA has a principle that changes to policy will only be made if the benefits clearly outweigh the costs. For example, to balance the introduction of prudential standards in 2012 aimed at protecting beneficiary's interests, APRA developed principles-based requirements that would provide some flexibility in their application and reduce regulatory burden on superannuation entities. Also, APRA's decision to introduce the suite of reporting standards in 2013 was made on the basis that the long-term benefits of the protection for superannuation beneficiaries as a result of the additional reporting requirements will likely outweigh the costs involved.

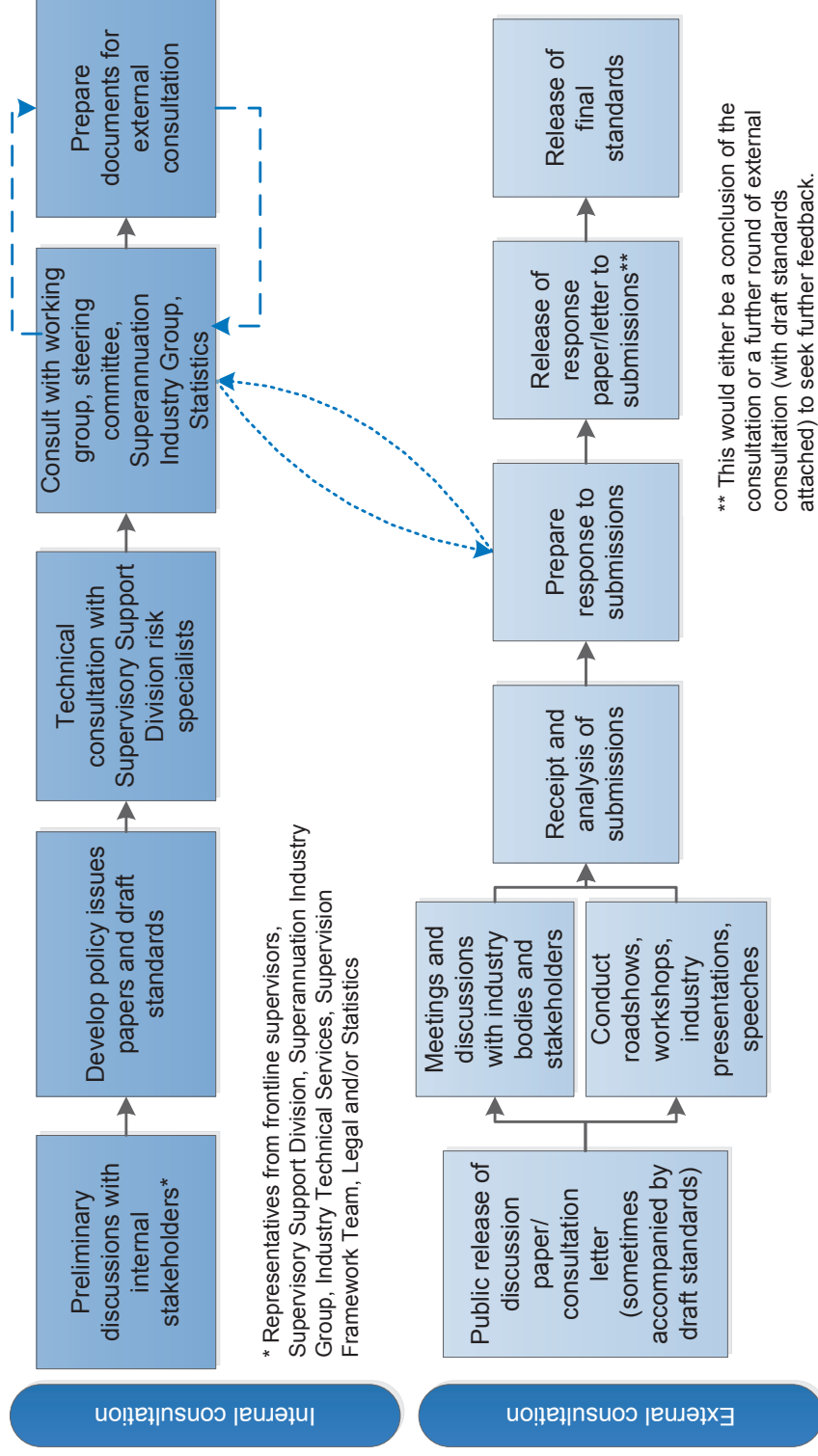
2.14 Policy initiatives relating to the development of prudential and reporting standards were added to APRA's Policy Priority Matrix. The Policy Priority Matrix presents APRA's prioritisation of policy projects based on their perceived urgency and strategic impact for APRA. It assists APRA in focusing its development of the prudential framework on priority areas for financial system safety and stability. It is presented to an Executive Board meeting for review and approval at least biannually.

Does APRA consult with stakeholders when determining standards and support superannuation entities to comply with standards?

APRA consults effectively with internal and external stakeholders in the development of prudential and reporting standards. It also provides a range of guidance to support superannuation entities to comply with prudential and reporting standards. The guidance is clear and consistent with the relevant standards and APRA's legislative powers.

2.15 Consultation is an important element of APRA's policy development process. As previously shown in Figure 2.1, APRA consults with internal stakeholders in the development of policy proposals before it undertakes external consultation with industry stakeholders. Figure 2.2 illustrates APRA's consultation process for the development of prudential and reporting standards.

Figure 2.2: APRA's internal and external consultation process



Source: ANAO analysis of APRA documents.

2.16 The ANAO found that APRA provided a reasonable time of two to three months for external consultation for prudential and reporting standards that were significant in terms of volume and impact. Those standards with shorter external consultation timeframes (two weeks to one month) were less material in nature or subject to MySuper implementation timeframes.

2.17 APRA has a transparent approach to consultation and publishes all the discussion papers/consultation letters it has released, non-confidential stakeholder submissions and APRA's responses to the submissions on its website. The total number of submissions received by APRA for each consultation is also published.

2.18 To ensure that all relevant views provided in stakeholder submissions are properly considered, APRA may hold several rounds of internal and external consultations before its final determination of the standards. APRA's meeting minutes and internal papers illustrated that it analysed the issues raised in submissions, deliberated the issues further with internal stakeholders, refined the requirements proposed in the standards and made amendments to the requirements as appropriate. APRA's response papers/letters to submissions acknowledged feedback received from external consultation processes and explained APRA's reasoning for final or revised prudential and reporting standards.

Guidance for prudential standards

2.19 APRA provides prudential practice guides as guidance material to support superannuation entities to comply with prudential standards. Prudential practice guides outline APRA's view on best practice in relation to particular areas of entities' businesses. Prudential practice guides are not legislative instruments and do not create enforceable requirements.²⁵

2.20 APRA issues prudential practice guides on particular matters once the relevant prudential standards are finalised. APRA also issues new prudential practice guides or amends existing practice guides where there are changes in the specific prudential standards that the practice guide is supporting.²⁶

2.21 APRA's internal subject matter experts provided input to the development of the prudential practice guides. The development of the prudential practice guides was also informed by internal and external consultations. During the external consultation process for prudential standards, APRA received feedback on additional areas where it might consider issuing guidance. APRA has incorporated that feedback, where relevant, into the development of prudential practice guides. APRA has been timely in issuing prudential practice guides to assist superannuation entities to meet prudential standard requirements, and issued 18 of its 19 superannuation prudential practice guides within six months of finalising the relevant prudential standards.

2.22 In some circumstances, APRA issues FAQs and letters to the superannuation industry to address specific issues that do not require amendments to the prudential standards or prudential practice guides. The issuance of FAQs and letters to industry enables APRA to provide guidance

25 Australian Prudential Regulation Authority, *Superannuation Prudential Practice Guides* [Internet], APRA, available from <<http://www.apra.gov.au/Super/PrudentialFramework/Pages/superannuation-ppgs.asp>> [accessed 4 July 2016].

26 The prudential practice guides issued replaced some of APRA's existing superannuation guidance material such as superannuation circulars, guidance notes and frequently asked questions.

promptly prior to any changes to a prudential standard or practice guide. Once the prudential matters have been incorporated in the final prudential standards or prudential practice guides, APRA will archive the FAQs previously issued in relation to those matters. As at 29 March 2016, there were 23 current FAQs and 67 archived FAQs in relation to prudential standards.

2.23 Prudential practice guides, FAQs and letters to industry are all published on APRA's website.²⁷ APRA also provides a link to all archived superannuation guidance material on its website so that entities know which material has been superseded.

Guidance for reporting standards

2.24 To assist superannuation entities in the completion of reporting forms, APRA provides guidance on the reporting requirements on its website.²⁸

2.25 APRA usually issues letters to industry to ensure that changes and clarification on superannuation reporting matters are communicated to the superannuation entities in a timely manner. On the occasion that APRA revised reporting standards, it issued an accompanying letter to industry to advise and explain the changes made. In addition, APRA issued letters to industry for each reporting period to outline general reporting-related information to help registrable superannuation entity licensees in submitting superannuation data to APRA.

2.26 Since the release of the suite of reporting standards between 2013 and 2015, APRA has received industry feedback and requests for clarification and guidance on the interpretation of the reporting standards. As a result of the reporting issues raised by industry, APRA released an extensive suite of FAQs on its website. The FAQs clarified the reporting issues and provided timely guidance to help superannuation entities comply with their reporting obligations. APRA's practice is to incorporate the FAQ guidance into the final reporting standards where it is appropriate to do so. The superannuation industry was notified of these amendments via letters to industry and APRA subsequently archived the relevant FAQs on its website. As at 24 March 2016, there were 27 current FAQs and 90 archived FAQs for reporting standards.

2.27 As part of APRA's internal governance process, all revised reporting standards and prudential practice guides, letters to industry, FAQs and other relevant guidance material are reviewed by the Legal Group to ensure they reflect the policy intent, are consistent with APRA's legal powers, and use clear and appropriate language.

2.28 There is an opportunity for APRA to consider other sources to inform revisions of guidance, including prudential review actions and reviews of entities subject to enforcement actions (refer to Chapter 5).

27 The guidance in relation to prudential standards is available on APRA's *Superannuation Prudential Framework* webpage: <<http://www.apra.gov.au/Super/PrudentialFramework/Pages/superannuation-prudential-framework.aspx>>.

28 These guidance and reporting standards can be accessed via <<http://www.apra.gov.au/Super/ReportingFramework/Pages/Super-reporting.aspx>>, <<http://www.apra.gov.au/Super/Pages/Superannuation-reporting-framework.aspx>> and <<http://www.apra.gov.au/Super/Pages/super-info.aspx>> [accessed 7 September 2016].

Does APRA review the appropriateness of prudential standards, reporting standards and prudential practice guides?

APRA has undertaken reviews and amendments of its prudential standards, reporting standards and prudential practice guides when industry issues or risks were identified or there were changes in government policy. However, APRA has not yet established a review program or scheduled a point-in-time review of the effectiveness and appropriateness of its suite of standards and prudential practice guides since their implementation in 2013. The timeframe for undertaking such a review is approaching given that APRA specified that they would be reviewed three to four years after their implementation.

2.29 According to APRA's Red Guide, a review of prudential standards, reporting standards and prudential practice guides should be scheduled post-implementation as part of the policy development process. The Red Guide provides that a short-term review of the standards and prudential practice guides should be scheduled within six to 12 months of implementation where the policy change is significant; while a longer-term review of the standards and prudential practice guides is usually scheduled two to three years following implementation depending on their nature and complexity.²⁹ In addition, the Red Guide provides that the standards and prudential practice guides should be amended as and when changes occur regardless of any scheduled reviews.

2.30 APRA stated in the Regulation Impact Statements prepared for superannuation prudential standards³⁰ and reporting standards³¹ that they would be reviewed after their implementation and on an ongoing basis to ensure that they are relevant, effective and continue to reflect sound practice. APRA also stated in the Regulation Impact Statements that there would be a point-in-time review of the appropriateness and effectiveness of the entire suite of superannuation prudential and reporting standards three to four years after their implementation.

2.31 To date, APRA's review of superannuation standards and prudential practice guides has been driven by changes in government policy and issues identified by industry or APRA supervisors. As outlined in paragraph 2.26, APRA made minor revisions to some of its reporting standards since their introduction as a result of matters raised by industry. In the last 12 months, APRA reviewed two elements of its superannuation prudential framework, which relate to:

- proposed changes to the governance arrangements for registrable superannuation entity licensees announced by the Australian Government in June 2015, which APRA addressed by proposing amendments to an existing standard and guide, and introducing a new standard and guide.³² The proposed legislative changes have not yet been passed in

29 The implementation of prudential standards could be considered a significant policy change. In this regard, the six to 12 months review timeframe may be inconsistent with the three to four year review timeframe for prudential standards as stated in the Regulation Impact Statement (refer paragraph 2.30).

30 Australian Prudential Regulation Authority, *Regulation Impact Statement: Superannuation Prudential Standards (OBPR ID: 14155)* [Internet], APRA, November 2012, available from <<http://www.apra.gov.au/Policy/Documents/Prudential-Standards-RIS.pdf>> [accessed 15 July 2016].

31 Australian Prudential Regulation Authority, *Regulation Impact Statement: Superannuation Reporting Standards (OBPR ID: 14624)* [Internet], APRA, June 2013, available from <<http://www.apra.gov.au/Policy/Documents/Superannuation-Reporting-Standards-RIS.pdf>> [accessed 15 July 2016].

32 APRA proposed to: amend SPS 510 and SPG 510; and introduce new SPS 512 and SPG 512.

Parliament, and accordingly the proposed changes to the prudential standards and guides have been put on hold; and

- updating the existing guidance material in the circulars for successor fund transfers and wind-ups by incorporating them in the form of a prudential practice guide, which APRA has envisaged releasing in the second half of 2016.

2.32 Although review and amendments of standards and prudential practice guides have been undertaken as changes and issues were identified, APRA has not yet scheduled a longer-term review of its standards and guides since their implementation. APRA's justification for this is that the usual timeframe for considering a review has not yet passed given that the standards and prudential practice guides were only implemented in 2013. APRA is currently exploring ways to establish a review program in line with its existing Red Guide requirements.

2.33 APRA should ensure that it undertakes a point-in-time review of the appropriateness and effectiveness of its suite of superannuation prudential standards, reporting standards and prudential practice guides as soon as practicable. Further, APRA should ensure that it establishes a program to support the ongoing review of standards and prudential practice guides at periodic intervals.

3. Licensing and registration

Areas examined

The ANAO examined whether APRA effectively processes licensing and registration applications for superannuation entities.

Conclusion

APRA has effective arrangements in place for processing licensing and registration applications for superannuation entities.

Area for improvement

The ANAO suggests that APRA make minor improvements to the forms and related guidance material for the licensing of superannuation entities (paragraph 3.4).

Does APRA provide appropriate forms and guidance in relation to the licensing and registration of superannuation entities?

APRA provides appropriate forms and guidance to support the licensing and registration of superannuation entities. The application forms are aligned with legislative requirements for the licensing and registration of registrable superannuation entities, and support applicants to provide relevant information in their application. APRA also publishes suitable guidance material on its website to assist entities with the application process. Minor improvements could be made to the licence application form and related guidance material.

3.1 Trustees of all registrable superannuation entities must have been granted a registrable superannuation entity licence by APRA to be able to register a registrable superannuation entity.³³ APRA provides application forms and instruction guides in relation to licensing and registration, and other relevant superannuation guidance material on the *Superannuation Licensing, Registration & Authorisations* webpage of its website. The licence and registration application forms are also available on APRA's *Forms for Superannuation Entities* webpage.³⁴

3.2 The application forms for licensing and registration both require the applicants to provide relevant information consistent with the provisions of the *Superannuation Industry (Supervision) Act 1993*. The applicants are also required to provide, as part of their applications, a list of supporting documentation and/or statements to demonstrate their likely compliance with the legislative requirements and the prudential standards determined under the *Superannuation Industry (Supervision) Act 1993*.

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- 33 Australian Prudential Regulation Authority, *Superannuation Licensing, Registration & Authorisations* [Internet], APRA, available from <<http://www.apra.gov.au/Super/Pages/superannuation-licensing.aspx>> [accessed 30 June 2016]. An applicant seeking to operate an APRA-regulated superannuation entity must be licensed by APRA. Once a licence has been granted, the licensee can apply to register a superannuation entity as a registrable superannuation entity. All registrable superannuation entities must be registered with APRA before commencing operations.
- 34 Australian Prudential Regulation Authority, *Forms for Superannuation Entities* [Internet], APRA, available from <<http://www.apra.gov.au/Super/Pages/forms-for-superannuation-entities.aspx>> [accessed 30 June 2016].

3.3 There are instruction guides for the licensing and registration application forms to assist entities in the completion of the forms. In addition, applicants are able to refer to the suite of guidance material that is published on APRA's *Superannuation Licensing, Registration & Authorisations* webpage for further support. The guidance material available includes superannuation legislation, prudential standards, prudential practice guides, circulars, frequently asked questions and material in relation to additional licence conditions.³⁵

3.4 The application forms and guidance in relation to licensing and registration are appropriate and aligned with the requirements of the *Superannuation Industry (Supervision) Act 1993*. However, the ANAO suggests that APRA make minor improvements to the licence application form and guidance as outlined in Table 3.1.

Table 3.1: Suggested improvements to licence application form and guidance

Suggested improvements	ANAO Comments
Emphasise the importance of notifying APRA of changes to the composition of the board of a body corporate or a group of individual trustees while licence application is pending.	On its <i>Applying for an RSE licence</i> ^a webpage, APRA provides forms to use for notifying such changes while an application is pending. However, the consequence of the application being deemed non-compliant with section 29C of the <i>Superannuation Industry (Supervision) Act 1993</i> if APRA is not notified is not clear in either the licence application form, forms for notifying changes or application instruction guide. Given that APRA cannot grant a registrable superannuation entity licence if the application is non-compliant, the importance of notifying APRA of changes should be made clearer in the forms and instruction guide.
Provide the acting trustee registrable superannuation entity licence application form on APRA's website.	Regulation 3A.03A of the <i>Superannuation Industry (Supervision) Regulations 1994</i> provides that acting trustee licences are a class of registrable superannuation entity licences. APRA currently states on its <i>Applying for an RSE licence</i> webpage in relation to acting trustee licences that: 'Please contact APRA's Enforcement area to discuss making an application. A new application form effective 1 July 2013 will be available shortly'. APRA should update this webpage to reflect its current administration in relation to this licence class.

Note a: RSE stands for Registrable Superannuation Entity.

Source: ANAO analysis of APRA's documentation and webpage.

Does APRA assess licence and registration applications in accordance with relevant requirements?

APRA assesses licence and registration applications in accordance with the requirements of the *Superannuation Industry (Supervision) Act 1993* and superannuation prudential standards. The assessment of the applications is consistent with APRA's internal guidance and procedures for licensing and registration. APRA's decisions about licence and registration applications are documented, timely and subject to appropriate assurance processes.

35 Although there is comprehensive published guidance material for licensing and registration of registrable superannuation entities, APRA strongly encourages applicants to consult with it before submitting a final application.

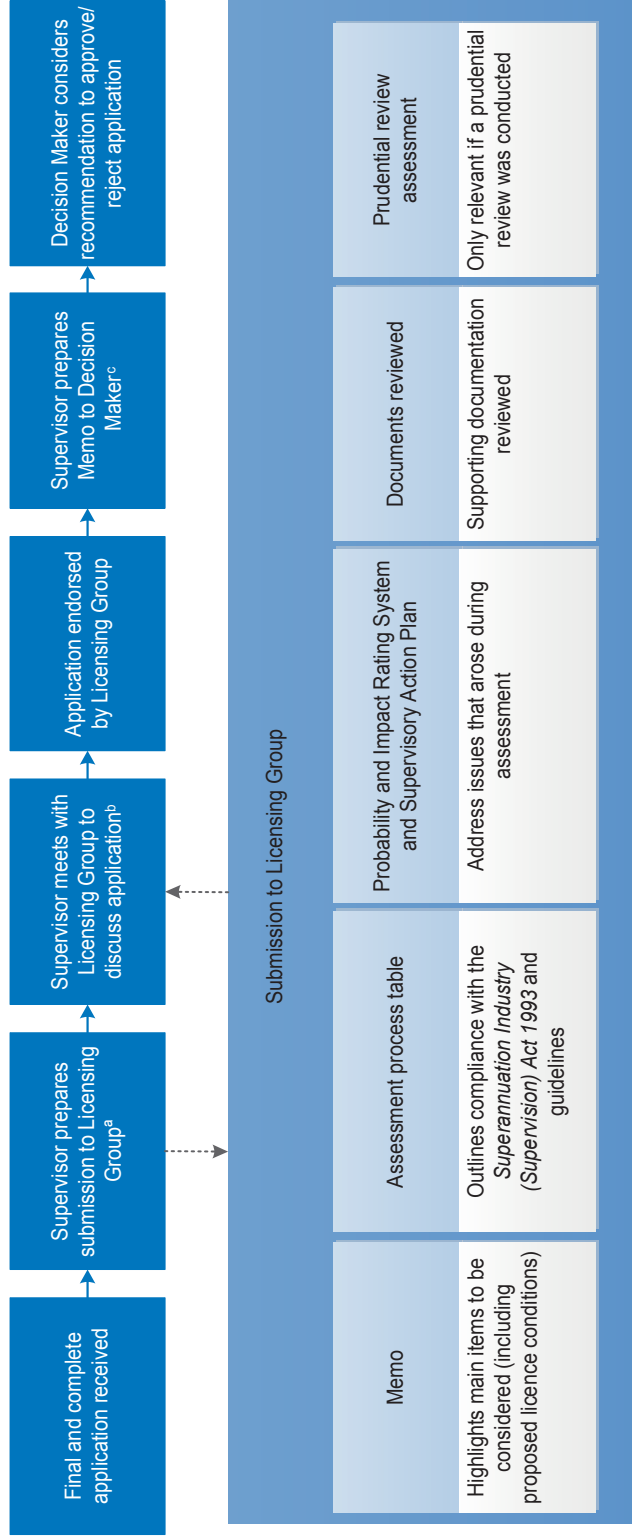
Application assessment

3.5 APRA's internal procedures provide appropriate guidance to supervisors responsible for the assessment of licence and registration applications. There are separate procedures for licensing and registration of registrable superannuation entities respectively. The procedures make reference to the relevant requirements under the *Superannuation Industry (Supervision) Act 1993* that have to be considered when processing an application. The procedures also provide information to supervisors on relevant guidance material and modules available to assist them in assessing an applicant's compliance with the prudential standards prescribed within the *Superannuation Industry (Supervision) Act 1993*.

Assessment of licence applications

3.6 The supervision team is required to assess the initial application material received against applicable requirements and expected prudential practices. The licensing process can be long and iterative, and often involves frequent engagement with the applicant by the supervision team and the redrafting of parts of the material submitted by the applicant. The supervision team may conduct an onsite prudential review if the applicant has existing business operations in Australia. The supervision team's assessment process for licence applications is illustrated in Figure 3.1.

Figure 3.1: Supervisor assessment process for licence applications



Note a: Licensing Group is made up of representatives from Supervision, Legal and relevant Supervisory Support Division risk specialists. APRA management appoints the Chair of the Licensing Group.

Note b: At least two meetings are required.

Note c: The Decision Maker is usually the Executive General Manager of the relevant APRA division—the Diversified Institutions Division or Specialised Institutions Division.

Source: APRA internal document.

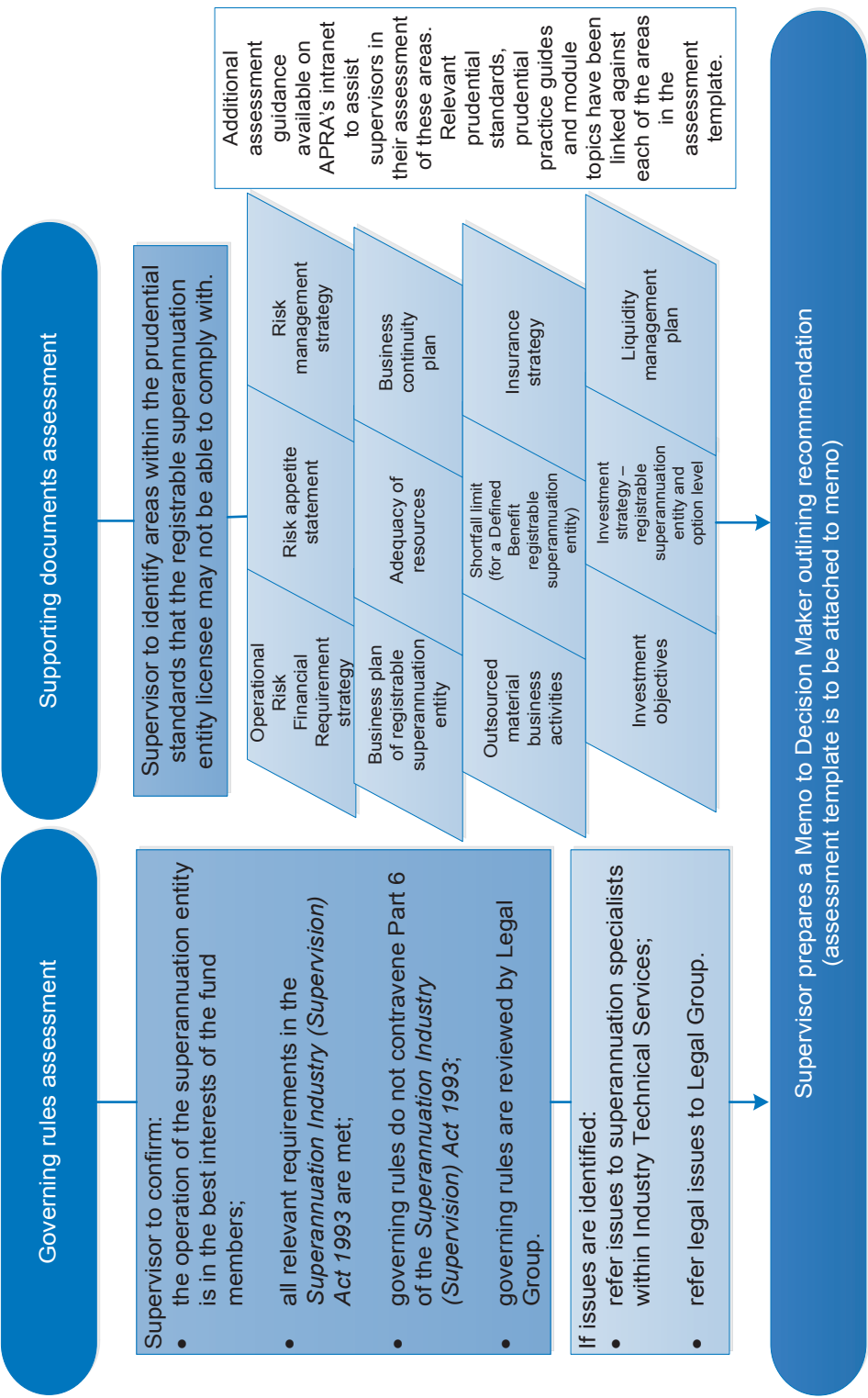
3.7 There has only been one registrable superannuation entity licence application granted since 1 July 2013. The ANAO reviewed APRA's assessment of this licence application that was granted on 1 April 2014 and found that the application was assessed against relevant requirements in the *Superannuation Industry (Supervision) Act 1993* and the prudential standards. APRA's assessment of the licence application was consistent with its licensing procedures. The supervision team's assessment as outlined in the submission to the Licensing Group indicated that additional information was requested from the applicant to assist the supervision team in making a complete assessment of the application.

Assessment of registration applications

3.8 An assessment template is available for supervisors to use in analysing the documents that are provided in the registrable superannuation entity registration application.³⁶ The key documentation that is assessed is: the governing rules/trust deed; and the statements and/or documents that demonstrate the entity's likely compliance with the prudential standards determined under the *Superannuation Industry (Supervision) Act 1993*. Figure 3.2 illustrates the supervision team's assessment process for registration applications.

³⁶ APRA encourages potential applicants to submit a draft registrable superannuation entity registration application for review before the final application is received in order to provide sufficient time for the supervision team to make an adequate assessment and address any preliminary prudential concerns.

Figure 3.2: Supervisor assessment process for registration applications



Source: APRA internal document.

3.9 Since 1 July 2013, there have been 164 registrable superannuation entity registrations granted. Of these registrations, 158 were for small APRA funds which are excluded from the scope of this audit. The ANAO reviewed APRA's assessment of the six remaining registrable superannuation entity registrations that were for a fund type other than small APRA fund and found that APRA's assessment of the six registration applications was consistent with its internal procedures and guidance. In all instances, the supervisor's assessment of the application was against the relevant legislative requirements. APRA also considered all available information and requested additional information, if relevant, via a formal written notice pursuant to section 29LA of the *Superannuation Industry (Supervision) Act 1993*. Where further information was requested, APRA provided a reasonable timeframe for the provision of the information.

Application decision-making

3.10 For licence and registration applications, the APRA delegate is required to consider the recommendation and assessment of the supervision team in determining whether to approve applications. The delegate's decision to approve a licence or registration application is formally made in a legislative instrument. APRA is required to advise the applicant in writing regarding the decision to approve, or not approve a registrable superannuation entity licence or registration.

Decision on licence applications

3.11 The ANAO's review of APRA's assessment of the licence application granted on 1 April 2014 confirmed that the decision to grant the registrable superannuation entity licence was documented and made in accordance with the provisions of the *Superannuation Industry (Supervision) Act 1993*. APRA's decision to grant the licence was made in the 'Decision to grant an RSE licence' document that subsequently enabled the registrable superannuation entity licence instrument to be formally generated. APRA then issued a cover letter to the applicant to advise the granting of the licence. APRA also provided the licensee with the registrable superannuation entity licence instrument, the 'Decision to grant RSE licence' instrument and a Statement of Reasons relating to the imposition of additional conditions on the registrable superannuation entity licence.

3.12 Pursuant to section 29CC of the *Superannuation Industry (Supervision) Act 1993*, APRA must make a decision on a licence application within 90 days after receiving the final application, with provision for an extension of a further 30 days. The ANAO's analysis found that the registrable superannuation entity licence application granted by APRA in April 2014 was determined within the prescribed legislative timeframe.

Decision on registration applications

3.13 The ANAO's review of APRA's assessment of the six registrable superannuation entity registration applications confirmed that the decisions to grant the registrations were made in accordance with the provisions of the *Superannuation Industry (Supervision) Act 1993*. APRA's decisions to grant the registrable superannuation entity registrations were each formally made in a 'Decision to register a registrable superannuation entity' instrument. APRA issued a cover letter with the registrable superannuation entity registration instrument to advise the licensee that the fund has been registered.

3.14 Pursuant to section 29LB of the *Superannuation Industry (Supervision) Act 1993*, APRA must decide a registrable superannuation entity registration application within 21 days after

receiving the final application or, where APRA has requested further information from the applicant, within 21 days after receiving all the information requested.³⁷ The ANAO's analysis found that the six registrable superannuation entity registration applications were all determined by APRA within the prescribed statutory timeframe.

Assurance processes on licensing and registration

3.15 The ANAO's analysis found that APRA's assessment processes of the licence and registration applications were subject to review and sign-off by the appropriate delegates in accordance with its internal decision-making procedures. The appropriate delegates re-examined the assessment of the supervision team to confirm the decision reached. Documents such as the Memo to Decision Maker, Statement of Reasons, registrable superannuation entity licence instruments and registrable superannuation entity registration instruments were also reviewed and approved by the Legal Group to ensure that the decision and processes followed are legally robust.

37 APRA may extend the time for deciding the registration application by up to seven days.

4. APRA's risk management arrangements and supervision framework

Areas examined

This chapter examines the adequacy of APRA's risk management arrangements and supervision framework to support the selection of supervision activities to be undertaken for the superannuation industry.

Conclusion

APRA's risk management arrangements and supervision framework provide a sound basis for supervising the superannuation industry, which has had few entity failures in recent years. Inconsistency in applying these processes has resulted in similar superannuation entities receiving varying levels of supervision and higher risk entities not consistently being subject to more intense supervision.

Areas for improvement

The ANAO made one recommendation aimed at improving the consistency of supervision of superannuation entities with similar risk profiles (paragraph 4.28). The ANAO also suggested that APRA adopt a more systematic approach to managing industry-wide risks (paragraph 4.13).

Do APRA's risk management arrangements support its supervision of the superannuation industry?

The design of APRA's risk management arrangements supports its supervision of the superannuation industry, including a detailed risk assessment system for individual superannuation entities. However, there is scope to improve the implementation of these arrangements. In particular, APRA can more consistently undertake individual superannuation entity risk assessments and better manage identified industry-wide superannuation risks.

Risk assessment of individual superannuation entities

4.1 One principle underlying APRA's supervision approach is to be risk-based.³⁸ As discussed in Chapter 1, to assist supervisors assess prudential risks associated with specific entities, APRA has had a risk assessment tool in place since 2002—the Probability and Impact Rating System (PAIRS).³⁹ The main objective of PAIRS is to measure the probability that an entity will fail and the impact of the potential consequences of that failure.

38 Other principles are being forward-looking, consultative, consistent and in-line with international best practice.

39 This tool is used across the various industries APRA is responsible for regulating and is applied to authorised deposit-taking institutions, general insurers, life insurers, friendly societies and registrable superannuation entities and their licensees. Small APRA superannuation funds and single member approved deposit funds are not subject to PAIRS.

4.2 In conducting a risk assessment, supervisors are required to evaluate specified categories⁴⁰ of a superannuation entity's operations by assigning a rating.⁴¹ APRA combines the probability rating with an impact rating, which is a score that reflects the consequence of an entity failing. Impact ratings are generally based on the value of entities' assets.⁴²

4.3 The ANAO analysed APRA's application of the PAIRS assessment model by examining the distribution of PAIRS scores by risk category for 484 PAIRS assessments prepared in relation to 138 trustees over the period 1 July 2013 to 23 March 2016 to determine whether the scores were consistent with PAIRS guidance and observations. This analysis found that the risk scores of trustees' administration were consistent with key elements of the PAIRS assessment model. For example, the model indicates that smaller trustees have lower inherent operational risk⁴³ as they have simple business flows and fewer transactions, and as illustrated in Figure 4.1, smaller trustees had lower scores for inherent operational risk. Further, larger trustees had lower scores for the management and control⁴⁴ of operational risk because, as outlined in the assessment model, they are more likely to have dedicated operational risk management functions.⁴⁵

40 These categories are: strategy and planning, liquidity risk, operational risk, market and investment risk, insurance risk, Board, management, risk governance, capital coverage/surplus, earnings and access to additional capital. Credit risk is a category in PAIRS but is not applied to superannuation entities.

41 Significance weights are assigned to each category of operations to determine entities' overall risk of failure. Significance weights are derived according to the importance of the PAIRS category to the overall business profile of the entity.

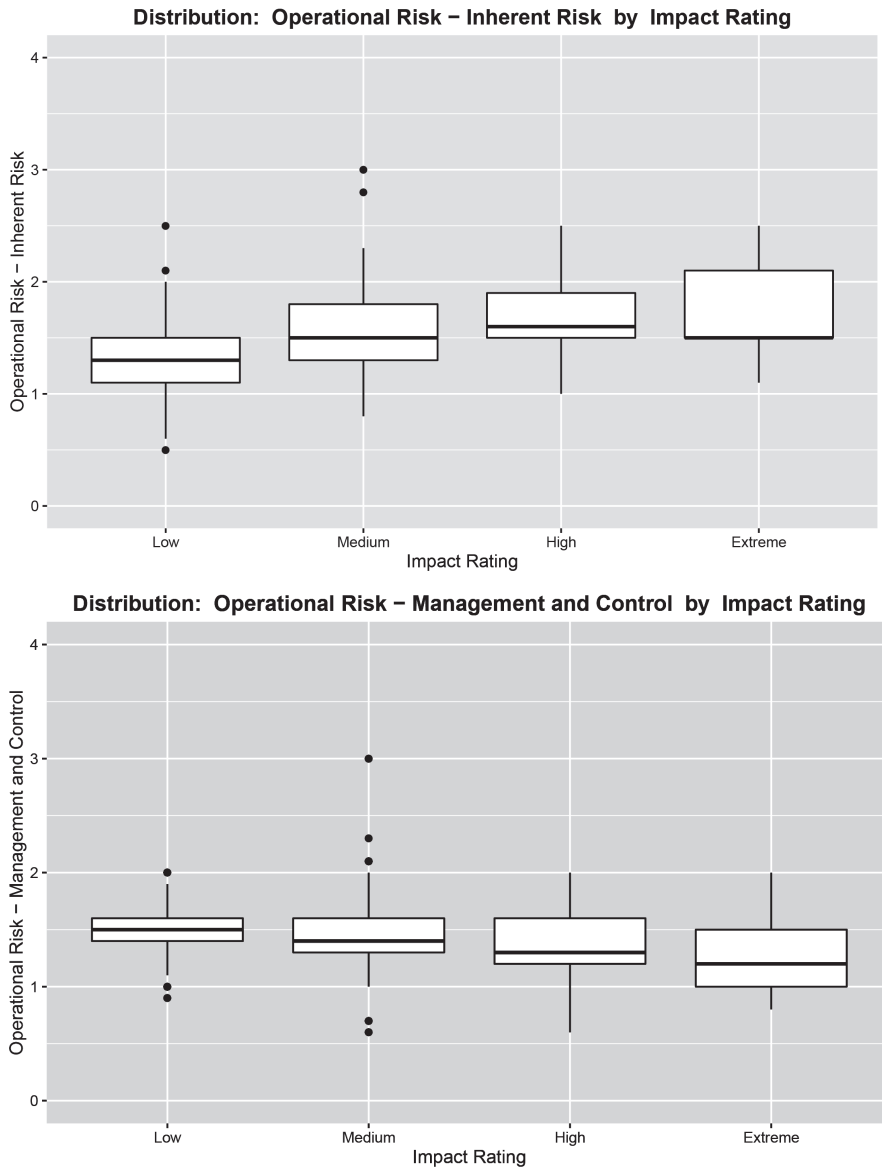
42 APRA's impact ratings are: low (<\$500 million); medium (\$500 million to \$5 billion); high (\$5 billion to \$50 billion); and extreme (>\$50 billion), based on an entity's total resident Australian assets. APRA can assign a higher impact rating to an entity when it has an impact disproportionate to its assets, for example, general insurers.

43 Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Inherent risk is any uncertainty in relation to the business operations of an entity.

44 APRA defines management and control as how an entity identifies, measures, monitors and controls its inherent risks.

45 Other areas where the risk scores were consistent with elements of the PAIRS assessment model included: larger entities with lower risk governance scores than smaller entities—APRA's guidance indicates larger entities are more likely to have comprehensive risk management arrangements; and smaller entities with higher scores for coverage—APRA's guidance indicates that these entities are likely to have only limited access to additional capital.

Figure 4.1: Distribution of PAIRS scores for operational risk of superannuation trustees, July 2013 to March 2016



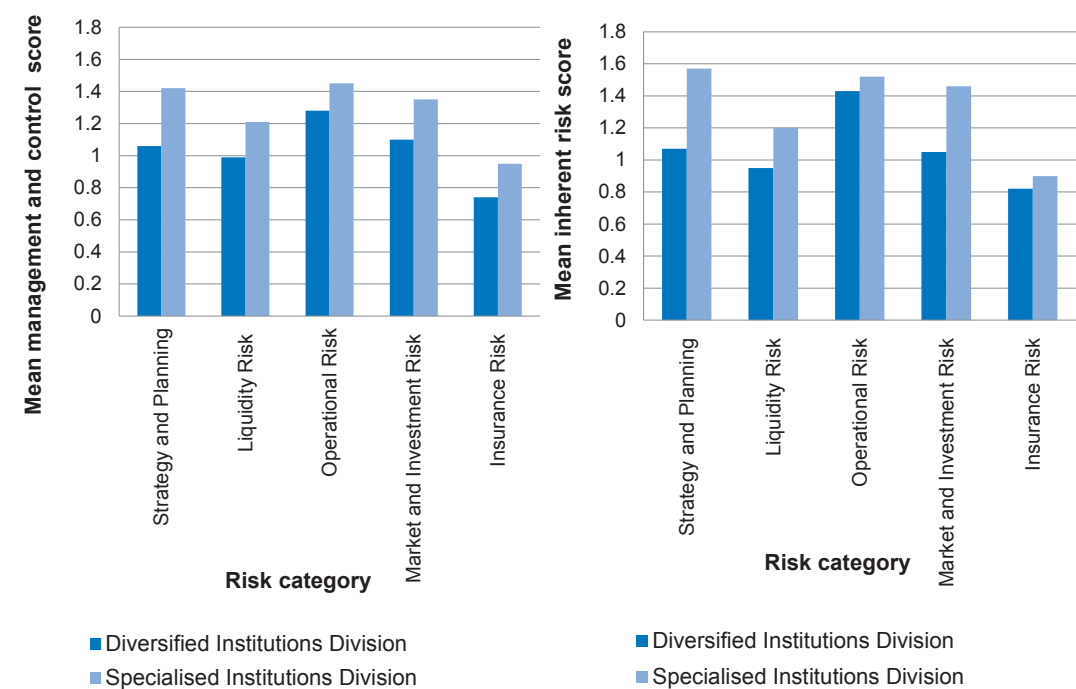
Note: The solid horizontal lines in the boxes represent the median value of the PAIRS scores, and the bottom and top of the boxes represent the first and third quartiles (interquartile-range), respectively. The vertical lines extending from the rectangle show the maximum and minimum values—the lines are limited to being the length of 1.5 times the size of the interquartile-range and will extend to the furthest point within that distance from the first and third quartiles. The dots above or below the extended lines represent data points that are further than 1.5 times the interquartile-range (outliers).

Source: ANAO analysis of the distribution of APRA's scores for inherent risk and management and control for operational risk by entity impact rating in 484 applicable PAIRS assessments.

4.4 APRA’s guidance indicates that the PAIRS should be updated when significant issues, events or analysis indicate that a trustee’s risk assessment should be revisited, following an onsite prudential review, and at a minimum, every 12 months. The ANAO tested if the PAIRS assessments for the 138 trustees had been updated within the past 12 months (March 2015 to March 2016) and only four assessments had not been—41 days was the most overdue.

4.5 The ANAO’s testing also found that entities supervised by staff in APRA’s Specialised Institutions Division were allocated higher scores for PAIRS categories than entities supervised by staff in the Diversified Institutions Division—even when controlling for size by assessing only high and extreme impact entities. APRA advised the ANAO that this variation in scores is not necessarily unexpected due to the difference in risk profiles and level of sophistication of the entities supervised within each division. However, as illustrated in Figure 4.2, the mean scores for inherent risk and management and control were higher for every risk sub category for trustees supervised by the Specialised Institutions Division than those supervised by the Diversified Institutions Division. These results are inconsistent with APRA’s PAIRS guidance (refer paragraph 4.3), which indicates that the smaller, standalone entities typically supervised in the Specialised Institutions Division will have lower ratings for inherent operational risk than the larger conglomerate groups supervised by the Diversified Institutions Division.

Figure 4.2: Mean PAIRS scores for inherent risk and management and control for five risk categories, by supervision of superannuation trustees by APRA Division, July 2013 to March 2016

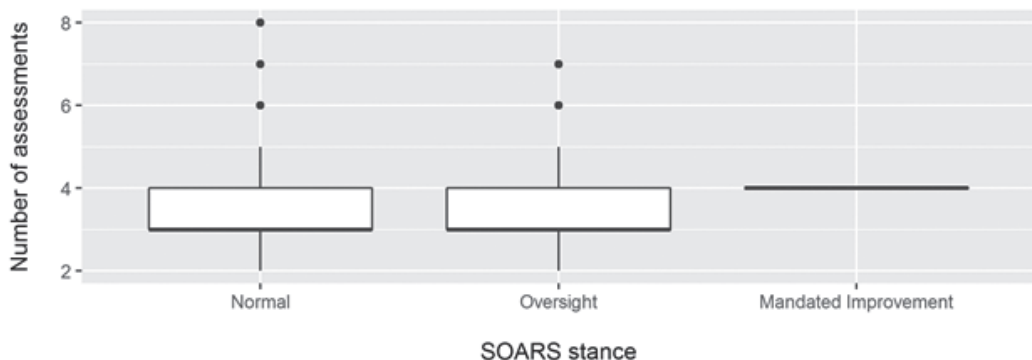


Source: ANAO analysis of the mean scores for inherent risk and management and control for five risk categories.

4.6 Other inconsistencies identified by the ANAO's testing among supervisors in preparing PAIRS assessments included:

- There was no clear relationship between an entity's supervision stance and the frequency of updating PAIRS assessments. As shown in Figure 4.3, the number of PAIRS assessments undertaken was:
 - similar for trustees with a normal and oversight supervision stance; and
 - higher for trustees with a normal and oversight supervision stance than those with a mandated improvement stance.⁴⁶
- In some instances, PAIRS assessments were completed for all associated registrable superannuation entities as well as trustees. APRA's guidance states that PAIRS assessments should only be undertaken at the trustee level and that the trustee PAIRS assessment should reflect any problematic entities.⁴⁷ For some PAIRS assessments there were differences between the trustee and registrable superannuation entities' PAIRS ratings, suggesting that supervisors had prepared separate PAIRS assessments to reflect differing risk characteristics.⁴⁸

Figure 4.3: Distribution of PAIRS assessments by SOARS stance, superannuation trustees, July 2013 to March 2016



Note: In total, four trustees had six PAIRS assessments; three had seven assessments; and one had eight assessments. The median number of PAIRS assessments was the same for trustees with a normal and oversight stances (three), while trustees with a mandated improvement stance had four PAIRS assessments completed during the period.

Source: ANAO analysis of the number of PAIRS assessments completed per entity by SOARS stance from July 2013 to March 2016.

46 APRA advised that where entities are undertaking significant activity across a range of areas, it will reconsider entities' risks and PAIRS ratings regardless of the Supervisory Oversight and Response System (SOARS) stance.

47 Of the 57 instances where PAIRS assessments were completed for trustees as well as their associated registrable superannuation entities, 11 of the trustees were multi-fund trustees and 46 were single fund trustees.

48 Exact numbers cannot be reported in relation to this analysis as the data did not allow all of the fund PAIRS assessments to be matched to a corresponding trustee record. For the registrable superannuation entity PAIRS assessments that could be matched, 40 per cent associated with multi-fund trustees and 62 per cent associated with single fund trustees had the same scores as the trustee PAIRS.

Industry-wide superannuation risks

4.7 APRA has an Industry Risk Management Framework in place to assist it to identify and manage heightened industry-wide risks; that is, common risks that are considered to have high possibility of significant adverse prudential consequences on any of the financial industries that it regulates (including superannuation).⁴⁹ A key feature of the framework is APRA's Heightened Industry Risk Register (Register) and Watch List. Risks recorded on the Register are those where there is a concern over business practices or other issues that pose industry-wide risks or affect many entities. Risks recorded on the Watch List are those risks that are not considered to be heightened risks but warrant ongoing attention.

4.8 The Superannuation Industry Group Chair is responsible for the risks recorded in the Register and Watch List that relate to superannuation entities.⁵⁰ A comprehensive review of the risks is conducted annually by the Superannuation Industry Group, supported by a paper submitted by APRA's Industry Analysis team that outlines existing risks as well as potential emerging risks.⁵¹

4.9 The framework encourages recording few risks on the Register to help ensure those listed receive appropriate supervisory focus. From 2013 to mid-2016, APRA had three to four risks recorded at any time on the Register and Watch List. The ANAO reviewed APRA's management of three risks recorded on the Register: liquidity, data integrity and insurance.⁵² While APRA effectively identifies and defines risks, it has an ad-hoc approach to managing and monitoring risks.

4.10 Risks recorded on the Register are assigned an owner who is required to present a scoping paper to the Superannuation Industry Group that describes the risk, and outlines the activities expected to be undertaken to mitigate the risk, including who will undertake the activities, when they will be undertaken and the expected outcomes.

4.11 The ANAO's analysis found that risks were listed on the Register for periods between three and 15 months before scoping papers were provided to the Superannuation Industry Group for approval. In three of the four papers, activities had been initiated in response to the risk prior to the approval of the scoping paper. None of the papers identified delivery dates and responsible officers for all activities. Without clear strategies and plans for managing heightened industry risks that identify outcomes, delivery dates and responsible officers, it is possible that relevant actions are not undertaken to address risks and that APRA is unable to assess its progress in managing risks.

49 APRA supervises five industries: authorised deposit-taking institutions; superannuation; general insurers; life insurers and friendly societies; and private health insurance.

50 The role of the Superannuation Industry Group is to identify current and emerging key risks and issues relevant to the superannuation industry and propose actions for APRA to address them.

51 To inform its paper, the Industry Analysis team conducts a survey of Specialised Institutions Division and Diversified Institutions Division supervisors in addition to APRA's risk, policy and technical teams. In 2014, a select group of 26 supervisors in the Specialised Institutions Division, Diversified Institutions Division and Supervisory Support Division were invited to participate in the survey.

52 APRA defines: liquidity risk as a key aspect of risk management for superannuation entities and their ability to meet their obligations to beneficiaries; data integrity risk as the risk of maintaining incorrect data as a result of inaccurate record-keeping, or inadequate or failed processes, people or systems; and insurance risk as the adequacy, sustainability and affordability of group life insurance arising from the superannuation industry's response to changes in pricing, approach to tenders and impact of constraints in market capacity. The Watch List was introduced in May 2014.

4.12 As required, risk owners provide progress reports to the Superannuation Industry Group in relation to scoping papers at least twice a year. The Superannuation Industry Group also receives information on activities to address risks from other teams, such as the Learning and Development team and Industry Analysis team. Nevertheless, the Superannuation Industry Group does not have oversight of how supervisors address industry risks through activities as this information can only be obtained through a manually-intensive review of supervisory action plans.⁵³

4.13 APRA could adopt a more structured approach to managing industry-wide superannuation risks. Scoping papers should be presented for approval to the Superannuation Industry Group as soon as practicable after a risk is identified and meet all the requirements of the framework, including identifying delivery dates and officers responsible for the delivery of identified responses. This would enable APRA to better focus its efforts on managing risks in a systematic and timely manner. More frequent updates that include reporting on indicators of effectiveness would also enable APRA to measure its success in addressing risks and provide insights for future risk management approaches. APRA should also introduce a process, such as a quality assurance review, that provides some transparency in relation to supervisors' management of heightened industry risks (Chapter 5). In accordance with its risk management framework, the ANAO suggests that APRA improve the timeliness and completeness of risk management strategies for heightened superannuation industry risks and consider requiring more regular and detailed progress updates to the Superannuation Industry Group in relation to these risks.

Enterprise risk management

4.14 APRA has an enterprise risk management framework that establishes APRA's risk appetite and the key principles and minimum requirements for managing risks. Within APRA's enterprise risk management framework, eight core risk areas were identified; of which three were directly relevant to APRA's supervision of superannuation entities: supervision analysis and review; supervision response; and prudential framework.

4.15 APRA's risk appetite statement is consistent with the principle of taking a proportionate, risk-based approach that is part of its prudential framework. For example, in relation to the supervision analysis and review risk, APRA's statement outlines its tolerance for aspects of supervision such as a moderate tolerance for less frequent interaction with smaller and/or lower risk entities with no known issues—consistent with APRA's supervision approach.

4.16 To mitigate some of the sub-risks within the supervision analysis and review, and supervision response risk categories, APRA identified mitigation controls including: application of its decision-making protocol; frontline supervision skills, experience and resourcing; quality assurance activities; and the consistent approach provided by APRA's supervision framework. The ANAO's analysis found that these measures do not ensure: consistency among supervisors (paragraphs 4.5 and 4.6) or appropriate coverage of heightened industry risks in supervision approaches (paragraph 4.12); and, do not provide assurance as to the quality of work undertaken

53 In examining the data integrity risk, the risk owners examined supervisory action plans and found the process inconclusive due to the level of inconsistency among supervisors. In 2015, APRA's Industry Analysis team also undertook a review of supervisory action plans prepared in 2014 and found that most did not reflect consideration of data integrity risk and where it was considered, many plans reflected the description of the risk as it appeared in the Register rather than the specific data integrity risk for the entity.

by supervisors (Chapter 5). To this end, APRA should consider whether these activities mitigate these risks to the extent expected.

Does APRA’s supervision framework support its supervision of the superannuation industry?

APRA’s supervision framework promotes a proportionate approach to undertaking supervision activities. It encompasses a minimum baseline level of activity determined by entity asset size (impact) and additional activity determined by assessed entity risk and size (supervisory stance). Within this framework, there were a number of instances where supervision had not been appropriately tailored to risk, including:

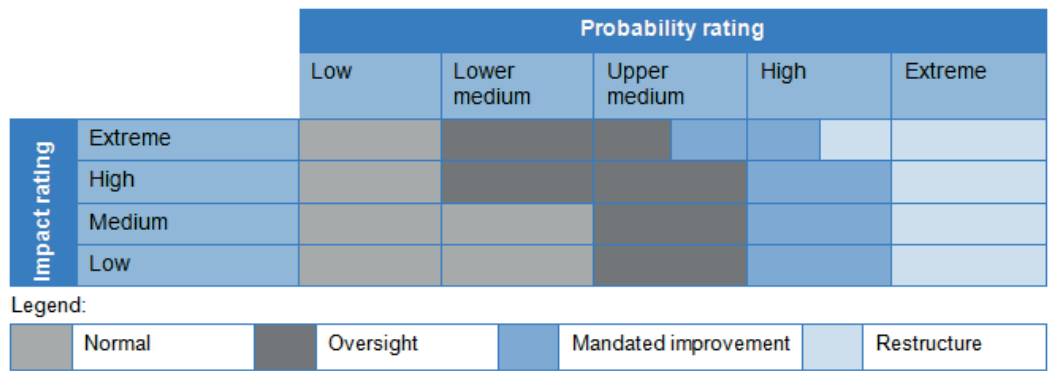
- entities with the same supervision stance were subject to varying levels of supervision activity;
- activities were sometimes undertaken in accordance with asset size rather than supervisory stance; and
- some entities were not subject to the baseline level of supervision activity.

4.17 APRA’s supervision approach as outlined in its blueprint⁵⁴, requires supervisors to identify entities’ risks and tailor supervision activities to determine whether the risks are being adequately managed. APRA’s Supervisory Oversight and Response System (SOARS), which has been in place since 2002, is designed to assist supervisors with implementing a risk-based and consistent approach across the financial industries it supervises, including superannuation.

Supervisory Oversight and Response System

4.18 SOARS is used to determine the supervisory stance to be applied to entities based on their PAIRS risk assessment, as illustrated in Figure 4.4.

Figure 4.4: Determination of supervision stance to apply to entities



Source: APRA internal document.

54 Australian Prudential Regulation Authority, *The APRA Supervision Blueprint* [Internet], APRA, available from <<http://www.apra.gov.au/AboutAPRA/Documents/APRA-Supervision-Blueprint-FINAL.pdf>> [accessed July 2016].

4.19 Entities with a higher supervision stance should be subject to more intensive supervision.⁵⁵ APRA promotes SOARS as its key tool for achieving a similar treatment for like entities.

4.20 The SOARS guide provides APRA staff with guidance about typical supervision activities by type of stance, for example indicating that entities with an oversight stance should have more frequent prudential reviews, and collection and analysis of data and reports than entities with a normal stance. APRA undertakes five key supervisory activities within its supervision framework, as outlined in Table 4.1.

Table 4.1: APRA's supervision activities

Activity	Description
Prudential review	Should be targeted at specific risk area(s) and are usually undertaken at entities' premises over three to five days.
Prudential consultation	Prudential consultations are held with the Board of an entity and/or its Senior Executive in relation to strategy and key issues, including those that are relevant to an entity's PAIRS ratings and supervision stance.
Quarterly risk review	Quarterly risk reviews are the assessment of financial data supplied by entities to APRA in addition to market and other prudential information to identify current and future risks and determine whether entities' PAIRS ratings or supervisory stance should be revised.
Lodgement analysis	Lodgement analysis involves reviewing other information provided by entities to APRA, such as audit and actuarial reports and risk management statements.
Other supervision activity	The SOARS guide outlines other activities for higher supervision stances, such as special investigations and requests for revised business plans for 'oversight', and requiring rectification plans and enforceable undertakings for 'mandated improvement'.

Source: ANAO analysis.

4.21 To test the consistency of supervision of like entities, the ANAO examined 2803 completed supervision activities for 138 superannuation trustees by SOARS stance for the period 1 July 2013 to 24 March 2016. This analysis illustrated that entities with the same SOARS stance have been subject to varying levels of scrutiny by APRA and that entities with higher SOARS stances have not been receiving more intensive supervision in all activity categories (Table 4.2). In particular, there is no clear graduated increase in the number of some supervision activities, such as prudential consultations and other supervisory activities, undertaken in relation to entities with higher SOARS stances.

⁵⁵ APRA's SOARS guide indicates that supervisory intensity needs to be consistently matched to the probability and impact of failure signals coming out of PAIRS.

Table 4.2: Level of supervision activity by SOARS stance, superannuation trustees, 1 July 2013 to 24 March 2016

Activity	Normal			Oversight			Mandated Improvement		
	Avg.	High	Low	Avg.	High	Low	Avg.	High	Low
Prudential review	1.7	5	0	2.2	6	0	3.0	5	2
Prudential consultation	0.4	4	0	1.0	3	0	0.3	1	0
Quarterly risk review	9.7	15	5	9.8	13	4	11.3	13	10
Lodgement analysis	2.4	4	1	2.5	4	0	3.0	4	2
Other supervisory activity	4.1	57	0	6.8	39	0	2.7	7	0

Note: 'High' refers to the largest number of activities recorded for an entity and 'low' refers to the least number of activities recorded for an entity.

Source: ANAO analysis of the 2803 completed supervision activities relevant to superannuation trustees undertaken from 1 July 2013 to 24 March 2016.

Baseline supervision requirements

4.22 APRA has established a baseline level of supervision activity considered necessary to identify key risks and issues within entities, as illustrated in Table 4.3.

Table 4.3: Baseline supervision requirements for entities regulated by APRA

Activity	Impact rating					
	Extreme	High	Medium	Low	Other	Tolerance
Prudential review	12 months	24 months	36 months		Nil	3 months
Prudential consultation	12 months	24 months	36 months			3 months
Quarterly risk review	Quarterly					
Lodgement analysis	As submitted or in next quarterly risk review					
PAIRS	12 months					
Supervisory action plan	12 months					
Contact with home regulator ^a	12 months					3 months

Note a: Relevant to foreign owned entities.

Source: Australian Prudential Regulation Authority, *Supervisory Oversight and Response System* [Internet], APRA, 2012, available from <http://www.apra.gov.au/CrossIndustry/Documents/SOARS_Final_May_2008_External_Version.pdf> [accessed 22 September 2016].

4.23 While entities' SOARS stances are driven by their impact and probability ratings, baseline activity is determined by an entity's impact rating (asset size). APRA's supervision blueprint indicates that impact provides an objective basis to carry out supervision activities with the purpose of assessing entities' key risks. However, once entity risks have been assessed and supervisors have prepared supervisory action plans, the blueprint indicates that baseline requirements remain the minimum level of activity that can be undertaken by supervisors. It is incongruous that the two methods for determining supervisory activity have alternative bases, and APRA should align the baseline requirements to SOARS to better reflect a risk-based supervision approach.

4.24 APRA's guidance for supervisors in relation to baseline activity indicates that while activities should be conducted consistently across entities, the depth and frequency of analysis may vary depending on the size or impact of an entity. The ANAO analysed whether the baseline level of activity had been implemented for the 138 trustees from 1 July 2013 to 31 March 2016. This was largely the case for prudential reviews, where all but two trustees had at least the minimum level (78 entities) or higher level (58 entities) of prudential review activity recorded. However, there were meaningful proportions of trustees not subject to the baseline level of prudential consultation and quarterly risk review. For prudential consultations, 13 entities⁵⁶ with extreme or high impact ratings were not subject to the baseline activity requirements and four entities with extreme or high impact ratings were subject to a greater level of supervision.

4.25 For quarterly risk reviews, Table 4.4 illustrates that almost one-third (45) of entities were not subject to the baseline level of quarterly risk review activity (highlighted in blue). The 46 entities with a level of activity that exceeded the baseline (highlighted in grey) are the result of the completion of 2012–13 quarterly financial analysis within the 2013–14 financial year. This is consistent with the ANAO's review of APRA licensee files that found instances of 'clustering' of quarterly risk reviews (Chapter 5).

Table 4.4: Quarterly risk review activity for superannuation trustees, July 2013 to March 2016

		Number of quarterly risk reviews for each trustee								
Impact rating	Baseline	4	5	6	7	8	9	10	11	>11 ^a
Extreme	10	0	0	0	1	0	1	4	0	1
High		0	0	0	1	5	4	18	9	7
Medium		0	0	0	2	6	9	17	15	4
Low		1	1	3	5	5	1	8	6	4

Note a: The ANAO examined the case with the highest number of quarterly risk reviews (15) and found that some of the reviews related to previous quarters, for example, April to June 2013, and were recorded as completed during the period reviewed by the ANAO.

Source: ANAO analysis of the level of quarterly risk review activity for each trustee in relation to baseline requirements.

56 APRA undertook a review of its files for these 13 entities and confirmed that four entities with a high impact rating were not subject to the baseline prudential consultation activity requirements. APRA further advised reasons for the remaining nine entities not having the required number of prudential consultations, however there was insufficient time for the ANAO to conduct file reviews to verify this information.

4.26 The ANAO's analysis indicates that, in some instances, impact also determines the level of supervision activity undertaken at the supervisor's discretion⁵⁷—that is, beyond the baseline level of activity. As illustrated in Table 4.5, the three entities with the more serious SOARS stance of mandated improvement, which would be expected to have a higher number of associated supervision activities, had between 11 and 30 recorded supervision activities. However, six entities with SOARS stances of normal and oversight but extreme and high impact ratings had over 41 activities recorded. The largest number of activities recorded for a single entity was 77 and that entity had a SOARS stance of normal but an impact rating of extreme.

Table 4.5: Number of activities by SOARS stance and impact rating as at 24 March 2016

	0–10	11–20	21–30	31–40	>41	Total
Mandated Improvement	0	2	1	0	0	3
Medium		2				2
Low			1			1
Oversight	2	36	17	7	4	66
Extreme		3	0	1	1	5
High		22	10	5	3	40
Medium	1	4	6	0		11
Low	1	7	1	1		10
Normal	6	49	9	3	2	69
Extreme					2	2
High		2	1	1		4
Medium		32	7	2		41
Low	6	15	1			22
Total	8	87	27	10	6	138

Source: ANAO analysis.

4.27 While APRA's supervision framework provides for a proportionate supervision approach based on risk with a required minimum level of activity, this approach is not consistently applied in practice. As noted in APRA's risk appetite statement, a risk-based supervision approach should enable APRA to deploy its workforce in a targeted and cost effective manner.

57 APRA advised that some activities are linked to legislative obligations rather than being discretionary such as breach notifications and responding to approaches from the entity.

Recommendation No.1

4.28 To promote proportionate, risk-based supervision of superannuation entities, APRA implements measures to provide greater consistency in the supervision of entities with similar risk profiles.

Entity response: *Agreed.*

4.29 *APRA accepts Recommendation 1 as fully aligned with initiatives within our 2016–2020 Corporate Plan, and believe the program of work we have established will drive towards sharper and more consistent supervisory decision-making.*

4.30 *The objective identified by the ANAO of continuing to enhance our risk-based approach to supervision is a priority for APRA. A strategic initiative in APRA's 2016–2020 Corporate Plan is aimed at sharpening APRA's risk-based management. The objective of this initiative is to support improved risk-based judgements, priority setting and resource management through enhanced supervisory tools and more structured risk intelligence and benchmarks. This initiative comprises a program of work that we believe will appropriately respond to the recommendation made by the ANAO.*

5. APRA's supervision activities and reporting

Areas examined

This chapter examines the effectiveness of APRA's superannuation industry supervision activities and reporting, including the management of supervisory activities, quality assurance processes and monitoring and reporting arrangements.

Conclusion

There is scope for APRA to improve the management of supervision activities for the superannuation industry, to support superannuation entities to better manage prudential risks on behalf of beneficiaries. Many of the activities reviewed by the ANAO were late and not recorded in the issues and document management systems, and APRA has limited external reporting of its supervision of the superannuation industry. Further, APRA does not have a quality assurance framework for its supervision work.

Areas for improvement

The ANAO made three recommendations aimed at APRA: electronically recording superannuation activities, including outcomes (paragraph 5.14); implementing a quality assurance framework (paragraph 5.30); and externally reporting the outcomes of its superannuation supervision activities (paragraph 5.40). The ANAO also made three suggestions aimed at APRA: establishing a framework to monitor the timeliness of supervision activities (paragraph 5.20); undertaking investigations of entities subject to enforcement action (paragraph 5.24); and better specifying key performance indicators to measure the timeliness, quality and implementation of superannuation supervision activities (paragraph 5.35).

Does APRA effectively manage supervisory activities?

While undertaking a substantial number of supervisory activities that have made many proposals for improved performance by superannuation trustees, APRA has not managed supervisory activities for the superannuation industry as effectively as it could have. The ANAO's analysis of 50 electronic trustee files found that only four per cent of the actions proposed in prudential reviews were recorded in APRA's issues management system, which has limited APRA's ability to monitor entities' responses to outcomes and analyse trends from this information in its industry risk analysis. Further, more than half of the superannuation supervision activities completed by APRA from 1 July 2013 to 24 March 2016 were overdue and a large proportion of prudential reviews examined by the ANAO were not recorded electronically in line with internal guidance. While few in number, APRA has not routinely reviewed its supervision of entities subject to enforcement action to identify opportunities to improve its broader supervision approaches.

5.1 Supervisors use APRA's supervision information technology system, Q, to plan and manage supervisory activities. Introduced in December 2013, Q automatically generates business-as-usual supervision activities, such as lodgement analyses and quarterly risk reviews. Supervisors enter other activities such as prudential reviews and consultations, and other supervision activities. Tasks are automatically generated for larger activities such as prudential reviews and

consultations and can also be manually recorded by supervisors. Q will change the status of activities to complete once all of the associated tasks have been completed.

5.2 The ANAO analysed a data extract of all APRA superannuation supervision activities recorded in Q for the period 1 July 2013 to 24 March 2016. In total, 3866 activities were recorded for superannuation trustees as illustrated in Table 5.1. The ANAO also conducted an electronic file review of 50 trustee files over the same period to assess the recording of actions arising from these activities and the completeness of the conduct of the activities.

Table 5.1: Superannuation trustee supervision activities and status, July 2013 to March 2016

Activity	Complete	Draft	In progress	Overdue	Planned	Withdrawn	Total
Prudential review	273	2	3	35	95	43	451
Prudential consultation	97	0	1	9	40	19	166
Quarterly risk review	1355	0	0	93	123	20	1591
Lodgement analysis	339	0	0	59	21	18	437
Other supervisory activity	739	3	14	88	244	133	1221
Total	2803	5	18	284	523	233	3866

Source: ANAO analysis of trustee activities undertaken from July 2013 to March 2016 by status.

Recording of actions arising from superannuation supervision activities

5.3 Prudential reviews can result in APRA directing entities to undertake a number of actions, including through: requirements, recommendations, suggestions and requests for information.⁵⁸ APRA's guidance requires supervisors to record all requirements and requests for information in its information technology system, the Activities and Issues Management System (AIMS). The guidance also 'encourages' supervisors to record recommendations and suggestions in AIMS. While not considered to be as significant as requirements and requests for information, APRA should consider requiring supervisors to record recommendations and suggestions to enable it to better identify common areas for improvement across the superannuation industry.

5.4 The ANAO's electronic file review of 50 trustee files included reviewing whether the actions from the prudential reviews had been recorded in AIMS. The ANAO's file review identified

⁵⁸ A requirement to take action is made where an entity has not been compliant with legislation or a standard, or where a risk management practice is fundamentally deficient; a recommendation is made where a risk management practice could be improved; a suggestion is made where there is an opportunity for an entity to move to better practice; and a request for additional information is made where issues may require clarification or further assessment, or progress updates are required on the implementation of a corrective action.

1148 actions from 82 prudential reviews⁵⁹ for the period of 1 July 2013 to 24 March 2016; of which only 46 actions (four per cent) had been recorded (Table 5.2).

Table 5.2: Recording of actions arising from prudential reviews of superannuation trustees, 1 July 2013 to 24 March 2016

Action	Identified by the ANAO	Recorded by APRA	Proportion not recorded
Recommendation	654	25	96%
Request for information	270	17	94%
Requirement	178	2	99%
Suggestion	46	2	96%

Source: ANAO analysis of data extract from AIMS of open issues and issues closed since 1 July 2013, and the results of the ANAO's review of 50 electronic trustee files, including 87 completed prudential reviews with accompanying documentation.

5.5 AIMS also records breaches reported by entities. APRA-regulated entities that become aware that they have breached, or will breach, a prudential requirement and the breach is 'significant'⁶⁰, are required to provide a report relating to the breach to APRA within ten business days of becoming aware of the breach. The ANAO analysed an AIMS data extract that included open items and items closed since 1 July 2013. As illustrated in Table 5.3, breaches represented the majority of items recorded. This may be because breaches reported through APRA's online breach reporting system are automatically recorded in AIMS.

Table 5.3: Number and status of issues recorded, July 2013 to March 2016

Item	Closed	Outstanding	Current	Total	Proportion
Breach notification	416	40	6	462	56%
Recommendation	148	10	3	161	20%
Request for information	87	7	6	100	12%
Requirement	30	2	1	33	4%
Suggestion	5	0	0	5	1%
Not applicable ^a	46	14	1	61	7%
Total	732	73	17	822	100%

Note a: APRA advised that issues can be recorded as not applicable for a range of reasons including if they do not require specific actions or are a follow-up action from an initial breach notification.

Source: ANAO analysis of the status of open issues and issues closed since July 2013 recorded in AIMS.

5.6 Accurately recording the actions of prudential reviews enables supervisors to monitor whether entities have completed the actions required by APRA—particularly relevant where the issue relates to a significant prudential regulation matter—and can signal when an issue should be

59 Five of the 87 prudential reviews examined did not have any proposed actions.

60 Significant breaches are outlined in Section 29JA of the *Superannuation Industry (Supervision) Act 1993* and include: the number or frequency of similar previous breaches; the impact on the trustee's ability to fulfil its responsibilities as trustee of the superannuation entity; and the actual or potential financial loss to the beneficiaries of the entity or to the trustee.

escalated for resolution. This information would also be relevant to APRA's: consideration of industry-wide risks as issues are recorded by PAIRS category; and review of prudential standards and associated guidance to assist in determining whether additional information or guidance may be required or if existing guidance requires amendment.

Completeness of supervision activities

5.7 The ANAO conducted an electronic file review of 50 trustee files to examine the extent to which the documentation required in APRA's guidance for prudential reviews had been completed, as well as the completion rate for quarterly risk reviews. Ahead of the implementation of its new information management system, APRA's record keeping policy is that hardcopy files remain the record of work performed. Nevertheless, it was agreed with APRA that the ANAO would test electronic records due to the cost and difficulty associated with accessing the hard copy files. Subsequent to this testing, APRA interrogated its hard copy files to identify records that were not stored in Q.

5.8 The ANAO examined 117 prudential reviews that were recorded in Q⁶¹, for the period 1 July 2013 to 24 March 2016. The trustee files were examined for documentation required by APRA's internal supervision guidance.

5.9 APRA's guidance on managing core prudential review documentation is inconsistent as it requires signed prudential review assessments and reports to be filed electronically while scoping documents are to be signed but not electronically filed. Nevertheless, the ANAO's electronic file review found that some supervisors electronically file all relevant prudential review documentation while others file none.

5.10 For thirty reviews (25.6 per cent), there was no documentation on the relevant trustee files—indicating that the reviews had not been completed or that the documentation had not been filed electronically.⁶² Fifty of the remaining 87 reviews (57.5 per cent) had incomplete documentation, mainly review assessments and scoping documents.⁶³

5.11 As part of the trustee file review, the ANAO also reviewed 492 quarterly risk reviews with a completed status; of which, 46 had not been completed⁶⁴, and 183 reviews had either been:

- completed late and as part of a cluster; that is, multiple quarterly risk reviews were completed on the same day rather than being completed following the relevant quarter; or

61 In total, 190 prudential reviews were recorded for the period; of which: 18 were MySuper product applications; five activities were recorded twice; 33 were planned for late 2016 or 2017; and 17 were withdrawn.

62 After interrogating its hard copy files to identify records that were not recorded in Q, APRA advised that there were no prudential reviews with no documentation—these were either recorded on the hard copy files, or the reviews were incorrectly recorded, deferred, cancelled, withdrawn or duplicate activities. The ANAO did not conduct file reviews to verify this information.

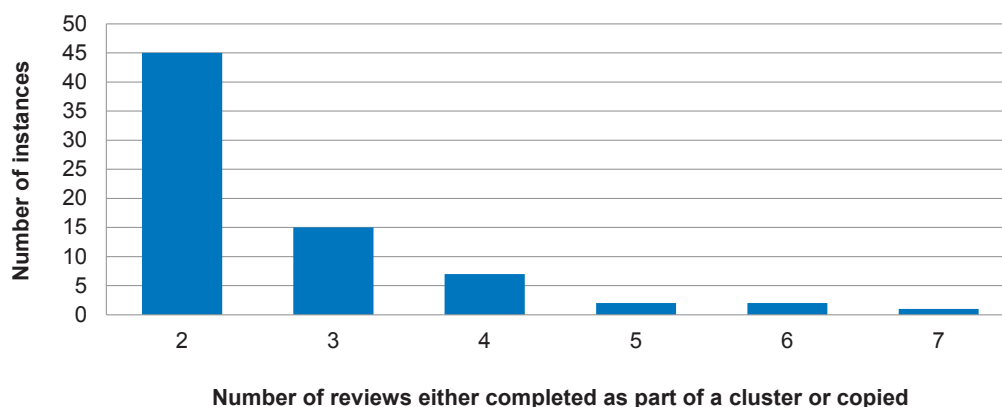
63 Assessments outline the findings and observations from the prudential review and are required to be signed by the participating supervision teams. Scoping documents outline the focus and approach of the review and are required to be signed-off in accordance with APRA's sign-off protocol.

64 APRA was unable to provide data records in relation to one entity that was wound up in 2015. That entity was an annual financial information lodger rather than a quarterly information lodger. The ANAO's electronic file review found that only one (2013) of two annual reviews had been completed for the entity.

- copied from previously completed quarterly risk reviews with no change.

5.12 As illustrated in Figure 5.1, the worst instance of clustering was seven reviews being completed on the same day for an entity with an oversight SOARS stance—indicating that this entity had not had quarterly risk reviews completed for almost two years.⁶⁵

Figure 5.1: Instances of quarterly risk review clustering



Source: ANAO analysis of 50 trustee files, including 492 completed quarterly risk reviews.

5.13 The ANAO's analysis identified shortcomings with APRA's record-keeping, including that key supervision activity outcomes were not recorded (paragraphs 5.3 to 5.6) and key supervision documentation was not stored electronically. APRA advised its record keeping policy is that hardcopy files remain the record of work performed. This position is inconsistent with the Australian Government Digital Transition Policy⁶⁶ that required government agencies to manage digitally created information in digital formats from 1 January 2016. The ANAO notes that, with offices geographically located around Australia, there would be benefit to APRA in adopting an electronic records management approach to enable information to be shared readily and without significant costs.

65 APRA advised that it has implemented a project to improve financial analysis across its supervision teams, including introducing toolkits and enhanced exception reports to better support supervisors in the conduct of timely, risk-based quarterly financial analysis.

66 National Archives of Australia, *Australian Government Digital Transition Policy* [Internet], July 2014, available from < <http://naa.gov.au/records-management/digital-transition-and-digital-continuity/digital-transition-policy/index.aspx> > [accessed 15 September 2016].

Recommendation No.2

5.14 To support effective and efficient administrative processes, APRA:

- (a) improves the recording of actions made in prudential reviews of superannuation trustees and uses the information in considering industry-wide risks and developing prudential guidance for trustees; and
- (b) introduces an electronic record keeping approach for its supervisory activities in accordance with the Australian Government Digital Transition Policy.

Entity response: *Agreed.*

5.15 *APRA accepts this recommendation as it is consistent with matters that APRA has identified and is addressing as part of the strategic initiatives within its 2016–2020 Corporate Plan.*

5.16 *At the time of the review, APRA's record-keeping policy required hard copy files as the official record of work performed. This issue will be addressed with the implementation of a new electronic Information Management System which is expected to be rolled out across the entirety of APRA by around the end of 2016.*

5.17 *APRA will also be implementing a more effective process for recording and monitoring actions arising from prudential reviews and other supervision activities as part of our Supervision Renewal Program (SRP). Implementation of the replacement system will be able to be progressed following completion of the roll-out of the new Information Management System.*

Timeliness of supervision activities

5.18 As outlined in paragraph 5.2, the ANAO analysed APRA superannuation supervision activities recorded in Q for the period 1 July 2013 to 24 March 2016, to assess the timeliness of these activities. All except one of the 1693 completed lodgement analyses and quarterly risk reviews had due dates recorded (as these are generated by Q)⁶⁷; of which, 764 (45.1 per cent) were recorded as completed earlier than or on the same day as the recorded due date, and 928 (54.8 per cent) were recorded as completed after the due date.

5.19 The ANAO also compared the planned and completed dates for prudential reviews and consultations and other supervisory activities with completed statuses.⁶⁸ Of these 1098 activities⁶⁹, 721 activities (65.7 per cent) were completed after the planned dates, with 611 activities (84.7 per cent) of these completed within six months of the planned date. The ANAO also analysed

⁶⁷ One quarterly risk review did not have a due date recorded.

⁶⁸ APRA's guidance states that planned date is an indicative start date only and that the confirmed activity start and end dates are only required to be completed if known by the supervisor. None of the prudential reviews, prudential consultations or other supervisory activities with completed statuses had due dates as APRA's guidance indicates that these fields are indicative and do not need to be completed.

⁶⁹ Eleven of the 1109 activities identified in Table 5.1 were excluded from this analysis as they did not have planned or completed dates.

the planned dates for 284 activities with an overdue status.⁷⁰ Most of these activities (192) were overdue by 180 days or less.

5.20 APRA should consider whether undertaking supervision activities within set timeframes is an important factor in managing the delivery of its work and if so, establish a framework to monitor the timeliness of supervision activities.

Enforcement action

5.21 APRA may take remedial action in instances where it has concerns in relation to an entity’s ability or willingness to rectify weaknesses that threaten its financial viability or safety. APRA has a Resolution and Enforcement team in place whose role is to advise and assist supervisors with applying APRA’s enforcement powers and to carry out enforcement action if necessary.

5.22 As illustrated in Figure 5.2, APRA’s enforcement principles are based on applying enforcement actions, available under the *Superannuation Industry (Supervision) Act 1993*, commensurate with the prudential regulation threat.

Figure 5.2: APRA’s enforcement principles and powers

APRA's Enforcement Principles	Resolution	Containment	General deterrence
	Resolving a matter with or without the use of a formal power.	Minimising impact on beneficiaries.	Indicate to industry that APRA will not accept misconduct.
Powers under the <i>Superannuation Industry (Supervision) Act 1993</i>	<ul style="list-style-type: none">Information seeking powersPower to require investigation of financial positionDirection PowersConditions on RSE Licence	<ul style="list-style-type: none">Power to commence an investigationRemoval and Replacement of TrusteesCancellation of RSE LicenceAdvice to Minister on 'Part 23' financial assistance	<ul style="list-style-type: none">DisqualificationCivil Penalty OrderCriminal offences

Source: ANAO analysis of APRA’s enforcement powers.

5.23 APRA’s Enforcement Steering Group is responsible for overseeing proposed and actual enforcement activities. From July 2013 to March 2016, the Enforcement Steering Group monitored significant enforcement actions against four entities, receiving monthly updates in relation to these entities.⁷¹ Some of these entities have been subject to enforcement action for a number of years as implementation of actions, such as court actions, can be lengthy and complex.

70 This analysis was based on the number of days between the planned date and data extract date (24 March 2016). APRA advised that some of these activities are not necessarily overdue and that this status may reflect tasks have not been undertaken within preferred timeframes or delays caused by entities.

71 APRA initiated enforcement action against one of these entities in 2001, another in 2007, the third in 2009 and the fourth in 2014.

APRA's enforcement response in relation to these entities has varied according to their circumstances, including: removing and replacing trustees; enforceable undertakings; court action; and advising the Minister on 'Part 23' financial assistance applications.⁷²

5.24 APRA's Enforcement Steering Group has undertaken a review of its management of one of the four entities—14 years after the entity was first subject to enforcement action. Reviews of APRA's management of these types of entities, potentially at various points including before, during and at the conclusion of enforcement action, would assist APRA to identify areas for improvement in its supervision approach. In particular, the circumstances relevant to the most recently identified entity should be reviewed by APRA to determine whether its supervision approach, training and guidance material, and/or guidance for entities, needs to be improved.

Does APRA have an effective quality assurance framework?

APRA does not have a quality assurance framework. It does not undertake independent reviews of supervisors' work such as financial and qualitative analysis or interactions with entities.

5.25 APRA does not have a quality assurance framework for its supervision activities, although it does undertake two activities aimed at improving the consistency of approach to preparing PAIRS assessments and supervisory action plans among supervisors: benchmarking sessions with supervisors; and Executive review of a selection of supervisory action plans.

5.26 Since 2013, APRA has undertaken four superannuation benchmarking sessions with supervisors. The sessions involve around five to seven (of 77) supervisors relevant to a common industry peer group⁷³, who discuss their approaches to PAIRS assessments, priority PAIRS categories and developing supervisory action plans. Outcomes of these sessions are made available on APRA's intranet, and quarterly reports are provided to the Executive of the Specialised Institutions Division and Diversified Institutions Division on whether participants have completed any resultant required actions. APRA advised the ANAO that informal benchmarking sessions are also conducted within the two divisions—the last one being held by the Diversified Institutions Division in 2013.

5.27 APRA's Executive⁷⁴ hold sessions to review the supervisory action plans for three to four entities selected by the Executive. Two of these sessions specific to superannuation have been held during the period reviewed by the ANAO—one in September 2013 and one in March 2016. Selection of supervisory action plans is ad-hoc and without a documented process. Supervisors attend these sessions and are required to respond to the Executive's queries, for example, explaining how the supervisory action plans address key risks. APRA advised that the outcomes of these sessions are reported to divisions by the respective Executive General Managers.

5.28 APRA also considers its sign-off protocol as a quality assurance mechanism. However, as noted in paragraph 5.9, the ANAO's file review found that documents are not consistently filed or

72 When an APRA-regulated fund becomes a victim of fraud or theft, the trustee can apply to the Australian Government for a grant under Part 23 of the *Superannuation Industry (Supervision) Act 1993* to recover part or all of the loss.

73 The institutions are selected by APRA's Supervision Framework Team.

74 The Executive Group includes the three APRA Members. APRA's Executive General Managers, Chief Risk Officer and General Counsel also attend these sessions.

signed off. Other risks associated with relying on a sign-off protocol as a quality assurance mechanism are that it does not: measure consistency across work areas⁷⁵; or address instances where there is misinformation or misunderstanding within a line of command. For example, as noted in Chapter 4, APRA's review of supervisory action plans in 2015 found that activities identified by supervisors to address data integrity issues had not been tailored to individual entities as was expected by the Industry Analysis team.

5.29 In August 2016, APRA's Management Committee considered a paper on establishing a quality assurance framework, commencing with a pilot. The paper recognised that APRA's quality assurance activities 'are not where they need to be and fall short of industry and better practice'. The framework is expected to, among other things, provide assurance that outcomes reflect consistent application of standards and practices; inform management decisions, including resource allocation; and identify areas that may benefit from further investment. APRA's quality assurance framework should include structured, risk-based quality assurance processes that in addition to examining whether supervisors follow documented procedures, examine the quality of work undertaken and the nature of interactions with supervised entities. Such a program would help APRA to detect and address inconsistent practices among supervisors as well as provide assurance to APRA's Executive as to the quality of supervision work being undertaken.

Recommendation No.3

5.30 APRA implements a quality assurance framework that includes independent reviews of the work undertaken by supervisors.

Entity response: *Agreed.*

5.31 *APRA's 2016–2020 Corporate Plan has recognised the need to strengthen our quality management practices. While APRA has a range of quality assurance mechanisms in place, we agree with Recommendation 3 that the framework needs to be strengthened, in particular through additional independent review processes.*

5.32 *Currently, APRA supervision is subject to a range of quality assurance mechanisms, designed to promote consistency and quality of supervisory assessments and decisions. Notwithstanding these mechanisms, APRA continues to build its quality assurance framework as part of a strengthening of its 'second line of defence' functions. In 2015, APRA appointed a Chief Risk Officer to build an enhanced risk and quality assurance function. The work program established for this function involves formalising a broader quality assurance framework that will strengthen existing quality control measures and ensure that there is enhanced review and effective challenge on core risk judgements, especially in relation to supervision. APRA is currently undertaking a pilot of a new quality assurance framework, designed to provide greater independent challenge and oversight, across selected supervision teams over the next couple of months.*

75 In some instances, the protocol may require input from a technical area, which should provide a level of consistency in dealing with those specific instances.

Does APRA effectively report internally and externally on the performance of its superannuation supervision activities?

There is limited oversight by APRA's Executive of the implementation of supervision activities, and APRA can better specify its key performance indicators to measure the timeliness, quality and implementation of supervision activities. While APRA reports stakeholder survey results by industry, it does not report any other disaggregated performance information by industry in its annual reports. Consequently, there is limited performance information available externally to enable stakeholders to form a view as to whether APRA is effectively supervising the superannuation industry.

Internal reporting

5.33 The Specialised Institutions and Diversified Institutions Divisions prepare quarterly performance reports that are provided to the Executive and include operational priorities in addition to reporting against key performance indicators (KPIs). Of 16 KPIs relevant to superannuation, the Specialised Institutions and Diversified Institutions Divisions share five: proactive supervision time; PAIRS and supervisory action plans that are greater than 12 months old; and two prudential review KPIs.⁷⁶

5.34 The Specialised Institutions Division monitors the number of some activities undertaken and aspects of compliance with baseline requirements. The Diversified Institutions Division has a greater focus on implementation of supervisory action plans, however, APRA is unable to measure this KPI through Q and instead it is informed by qualitative assessments carried out by the Diversified Institutions Division General Managers. The Diversified Institutions Division does not have KPIs to measure the level of baseline activity.

5.35 The KPIs for the Specialised Institutions and Diversified Institutions Divisions do not focus on supervision activity timeliness, completeness, targeting or accordance with SOARS stance. APRA is also unable to reliably measure whether supervisory action plans are implemented. The ANAO suggests that APRA reviews internal KPIs of supervisory activities to better reflect the timeliness, quality and implementation of supervision activities.

External reporting

5.36 APRA reports externally on its supervision performance in annual reports, as illustrated in Table 5.4, which also include supervisory and regulatory activities by industry. APRA's performance results are reported at an aggregate level across all of the industries that APRA supervises⁷⁷, and provide little insight into the effectiveness of APRA's supervision efforts within individual industries, including superannuation.

⁷⁶ Proactive supervision time is the time spent on activities initiated by APRA, for example, quarterly risk reviews and prudential reviews and consultations. APRA has internal KPIs for the prudential review process including that: final reports for prudential reviews carried out jointly by supervision teams and the Supervisory Support Division must be signed off by the two teams within 15 days of the closing meeting with the entity; and final reports must be issued to the entity within 20 days of the closing meeting.

⁷⁷ In 2013–14, APRA reported on enforcement and related actions undertaken by industry, however, in 2014–15, APRA did not include this information in its annual report.

Table 5.4: APRA's performance reported in 2013–14 and 2014–15 annual reports

2013–14	2014–15
<ul style="list-style-type: none">• Performing Entity Ratio and Money Protection Ratio since 1998–99^a• SOARS transition matrix for 2007–14^b• Number of entities that moved out of the SOARS stances of mandated improvement and restructure following APRA's intervention• Number of enforcement and related actions undertaken in each industry during 2013–14	<ul style="list-style-type: none">• Performing Entity Ratio and Money Protection Ratio since 1998–99• Number of entities that moved out of the SOARS stances of mandated improvement and restructure following APRA's intervention• Compliance with the Office of Best Practice Regulation's policy-making process• Status of the regulatory cost savings project that commenced in 2014• 2015 stakeholder survey results^c

Note a: The Performing Entity Ratio is an indicator of the incidence of failure for regulated entities. The Money Protection Ratio is an indicator of the incidence of loss in the financial sector. A higher ratio indicates a lower incidence of failure or loss. The annual Performing Entity Ratio and Money Protection Ratio have averaged 99.92 per cent and 99.96 per cent respectively since APRA's inception in 1998.

Note b: The SOARS transition matrix illustrates movements of APRA-regulated entities through supervision stances.

Note c: Only shows the results for the top five and bottom five rated items from APRA's 2013 and 2015 biennial stakeholder surveys.

Source: ANAO analysis of APRA Annual Reports for 2013–14 and 2014–15.

5.37 APRA also reports the results of its biennial surveys of regulated entities on its website⁷⁸, which reflects stakeholder feedback on its performance. The 2015 Stakeholder Survey results show that superannuation trustees rated APRA strongly in relation to its prudential approach and conduct of supervisory activities.

5.38 For 2015–16, APRA has revised performance reporting requirements, including:

- publishing its first report on the validated self-assessment outcomes against the Australian Government's Regulator Performance Framework⁷⁹; and
- developing an annual performance statement as required under the *Public Governance, Performance and Accountability Act 2013*.⁸⁰

5.39 APRA's performance information should help industry, beneficiaries and stakeholders, including Parliament, to form a judgement on whether it is achieving its purposes.⁸¹ Including the stakeholder survey results at the industry level in its annual report provides a measure of the

78 APRA undertakes these surveys to understand the impact of its prudential framework and the effectiveness of its supervision.

79 APRA is required to measure and report on the performance of its regulatory functions in accordance with the framework that applied from 1 July 2015. As required under the Regulator Performance Framework, APRA has developed a range of metrics and examples of evidence for the annual self-assessment of its performance against the six key performance indicators under the framework. APRA's self-assessment is required to be externally validated by a stakeholder group.

80 APRA is also required to produce a corporate plan, measure its performance against the plan and report its performance results in accordance with the Enhanced Commonwealth Performance Framework, which came into effect on 1 July 2015. APRA has developed a range of quantitative and qualitative performance indicators to assess its performance against the strategic objectives set out in its Corporate Plan 2015–19.

81 APRA is established for the purposes of prudential supervision of financial institutions and for promoting financial system stability in Australia. In relation to superannuation, APRA is responsible for protecting the interests of superannuation fund members.

effectiveness of APRA's activities in the superannuation industry. However, APRA should include additional performance information for the superannuation industry to complement these results and provide a more meaningful representation of its achievements. Additional information could include: the number and type of activities undertaken; the actions resulting from those activities; information relating to its enforcement actions; and extension of the current external performance reporting disaggregated to the superannuation industry (Performing Entity Ratio, Money Protection Ratio and the number of entities that moved out of mandated improvement and restructure stances, as per Table 5.4).⁸² This information would more transparently reflect APRA's supervision efforts in relation to the superannuation industry; the effectiveness of those activities; and the relative 'health' of the industry.

Recommendation No.4

5.40 APRA's public reporting provides a meaningful representation of whether APRA is achieving its purposes in supervising the superannuation industry.

Entity response: *Agreed.*

5.41 *APRA accepts this recommendation, which is consistent with work the organisation has had underway for some time.*

5.42 *As part of an increased focus on improving organisational effectiveness, APRA established a project in 2014/15 to enhance our internal and external performance reporting, including key performance indicators, with a view to publishing improved performance metrics for 2016/17. This will cover all supervised industries, not just superannuation.*



Grant Hehir
Auditor-General

Canberra ACT
23 November 2016

82 Department of Finance, *Resource Management Guide No. 131: Developing good performance information* [Internet], April 2015, available from <<https://www.finance.gov.au/sites/default/files/RMG%20131%20Developing%20good%20performance%20information.pdf>> [accessed 15 September 2016].

Appendices

Appendix 1 Australian Prudential Regulation Authority response

AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY
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WAYNE BYRES
Chairman

4 November 2016

Mr Andrew Morris
Executive Director
Performance Audit Services Group
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

Dear Mr Morris

PROPOSED REPORT - PRUDENTIAL REGULATION OF SUPERANNUATION ENTITIES

Thank you for the opportunity to provide a response to the proposed report by the Australian National Audit Office (ANAO) on the *Prudential Regulation of Superannuation Entities* by the Australian Prudential Regulation Authority (APRA).

APRA would like to thank the ANAO and its staff for the thoroughness of the review and their cooperation throughout the preparation of the report. APRA is also pleased to note the ANAO's conclusions that:

- APRA has effective arrangements in place for setting prudential and reporting standards and providing guidance to assist superannuation entities to comply with the requirements of the standards;
- APRA has effective arrangements in place for processing licensing and registration applications for superannuation entities; and
- APRA's risk management arrangements and supervision framework provide a sound basis for supervising the superannuation industry.

The proposed report contains four recommendations and a number of suggestions that, when implemented, will enhance the quality of APRA's supervision of superannuation, as well as the other areas of the financial sector for which APRA has responsibility. Importantly, the recommendations and suggestions align with initiatives that APRA has already identified for action in our 2016-2020 Corporate Plan.¹

Recommendation 1 of the ANAO's proposed report relates to APRA's risk-based supervision approach. We accept Recommendation 1 as fully aligned with our own plans, and believe the program of work we have established will drive towards sharper and more consistent supervisory decision-making.

¹ www.apra.gov.au/AboutAPRA/Publications/Pages/Corporate-Plan.aspx

APRA considers that effective, risk-based supervision involves identifying risks at an idiosyncratic, industry and financial system level (consistent with our obligations under Section 10(1) of the APRA Act). This requires APRA to allocate resources from a risk perspective to not only those institutions that present a higher risk individually, but also to those that present a higher risk to the financial system in the event they encounter financial difficulty. This will not be achieved by a simple, linear approach of undertaking a certain number of activities per institution. Indeed, we consider it to be reflective of a risk-based approach to supervision that, based on individual entity circumstances, there is variation in the number and nature of supervision activities for entities within a particular supervision stance - which are themselves very broad categories - as well as across different supervision stances.

The ANAO report makes a number of specific observations in relation to APRA's supervisory approach, on which we would like to note the following:

- The report finds that the mean scores for inherent risk and management and control were consistently higher for trustees supervised by APRA's Specialised Institutions Division (SID) than those supervised by the Diversified Institutions Division. As noted in the report, APRA considers that the outcome is not necessarily unexpected, given the difference in risk profiles and level of sophistication of approach (on average) of the entities supervised within each division. For example, superannuation entities in DID are typically part of larger conglomerate groups and able to leverage off (generally more mature) group frameworks and approaches, whereas SID entities are typically smaller stand-alone organisations. However, the ANAO notes that APRA's rating guidance material is not always consistent with this perspective, so APRA will review its PAIRS guidance accordingly.
- The report suggests that APRA should align the basis for SOARS and baseline requirements to better reflect a risk-based approach. APRA has adopted the baseline approach because it considers that a minimum level of supervision activity is necessary for all entities of a broadly similar size, which should be undertaken regardless of their risk profile. This helps to ensure that risk-based decisions on the discretionary use of supervisory time and effort are based on a common foundation, and provides an objective base from which to determine risk-based priorities.
- The report notes that entities in higher risk categories are not receiving more intensive supervision in all activity categories (table 4.3). It is important to note that APRA does not expect them to in every instance. The vast bulk of superannuation entities (98 per cent) have a SOARS stance of either Normal or Oversight, and in these categories the broad pattern is one in which:
 - the two categories of activity which the report highlights as not increasing in frequency as an entities SOARS stance increases - Quarterly Risk Reviews and Lodgement Analysis - are not intended to be highly discretionary, so should not vary notably; and
 - in the other three activity categories, for which more discretion is given to supervisors to tailor activity to assessed risk, there is an increase in average frequency as assessed risk rises, as expected, between Normal and Oversight entities.

The ANAO has noted that this general trend does not apply to the small number of Mandated Improvement entities, but these entities are typically subject to specifically targeted supervisory action plans.

- The report often uses activity counts to test consistency of approach. Activity counts are, at best, only a very rough proxy for actual supervisory intensity: different activities may involve varying degrees of supervisory effort (in terms of the number of staff involved and time taken). One of the challenges for assurance functions - including that performed by regulators and auditors - is to measure the effectiveness of the work performed. As we discuss further below, we are developing metrics which seek to better measure the effectiveness of our supervisory activity. In doing so, we wish to focus where possible on outcomes, rather than outputs, as our measure of effectiveness.

Notwithstanding the above, the objective identified by the ANAO of continuing to enhance our risk-based approach to supervision is a priority for APRA. One of the strategic initiatives in APRA's Corporate Plan is aimed at sharpening APRA's risk-based management. The objective of this initiative is to improve support for risk-based judgements, priority setting and resource management through enhanced supervisory tools and more structured risk intelligence and benchmarks. The strategic initiative comprises a program of work to:

- inform judgements through clear risk appetite and strengthened risk intelligence;
- improve APRA's risk and performance assessment and reporting capability;
- formalise quality management practices; and
- enhance resource management practices.

We believe this program will appropriately respond to the recommendation made by the ANAO.

Recommendation 2 deals with effective and efficient administrative processes. Again, we fully accept this recommendation as it is consistent with matters that APRA has identified and is addressing as part of the strategic initiatives within its Corporate Plan.

At the time of the review, APRA's record-keeping policy still required hard copy files as the official record of work performed. However, for logistical reasons, it was agreed that the ANAO would conduct its testing based on electronic files. The ANAO subsequently noted a number of instances of no or incomplete documentation in these electronic files. APRA has subsequently reviewed the official files for the trustees selected by the ANAO and confirmed that for a significant number of the institutions the relevant documentation is contained in the official hard copy file. In some cases, the relevant documentation was contained in the group supervision electronic directories, rather than those for the superannuation entity, as the activity was undertaken as part of supervision at the group rather than entity level.

This issue will be rectified, and APRA will move into compliance with the Australian Government Digital Transition Policy, with the imminent introduction of an electronic record-keeping system as the official record-keeping system for APRA's supervisory (and other) activities. APRA is currently in the pilot stage of implementing a new Information Management System (based on SharePoint) and, upon completion of the pilot phase that is currently underway, it is envisaged that the system will be rolled out across the entirety of APRA by around the end of 2016.

More specifically in relation to tracking actions required of regulated entities, APRA will be implementing a more effective process for recording and monitoring actions arising from prudential reviews and other supervision activities as part of our Supervision Renewal Program (SRP). Inadequacies in the current Activities and Issues Management System (AIMS) have been known for some time, and APRA management have not enforced its use in recent

years. Informal, typically spreadsheet-based, systems have been used in the interim to record and monitor progress in relation to these actions. Further action on an AIMS replacement will, however, require completion of the Information Management System to be free up the necessary resources.

Recommendation 3 deals with quality assurance. APRA's Corporate Plan for 2016-2020 has recognised the need to formalise and enhance our quality management practices. While APRA has a range of quality assurance mechanisms in place, we agree with Recommendation 3 that it needs to be strengthened, in particular through additional independent review processes.

APRA's supervision philosophy requires supervisors to make judgements. It is therefore critical that those judgements be exercised within a framework designed to promote consistent decision-making across the organisation. Currently, APRA supervision is subject to a range of quality assurance mechanisms, designed to promote consistency and quality of supervisory assessments and decisions:

- a supervisory framework and toolkit has been established by APRA's central Supervision Framework Team, designed to ensure supervisors conduct their activities in a broadly consistent manner, and with extensive guidance material to help inform and base judgements;
- the potential for the use, particularly for more complex institutions, of risk specialists from outside the supervisory team for prudential reviews, which add cross-industry perspective to risk assessments and aid consistency;
- the PAIRS risk rating systems, and SOARS supervisory response system, designed to deliver consistent risk assessments and supervisory responses, using a consistent lexicon;
- formal and informal benchmarking sessions, which allow supervisors to compare and contrast supervisory assessments across peer institutions;
- we have recently reinstituted the review of selected risk assessments and action plans by the senior executive;
- sign-off protocols that ensure more senior oversight of, and agreement with, supervisory assessments;
- a decision-making framework which requires that certain decisions involve external (to the supervision team) input and advice;
- a delegation framework that ensures supervisory decisions of importance are only taken by appropriately delegated officers; and
- an escalation procedure to deal with instances where there are differences of opinion as to the appropriate course of supervisory action.

Notwithstanding these mechanisms, APRA continues to build its quality assurance framework as part of a strengthening of its 'second line of defence' functions. In 2015, APRA appointed a Chief Risk Officer to build an enhanced risk and quality assurance function (a move now being copied by prudential supervisors elsewhere in the world). The work program we have established involves formalising a broader quality assurance framework that will strengthen

Australian Prudential Regulation Authority

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existing quality control measures and ensure that there is enhanced review and effective challenge on core risk judgements, especially in relation to supervision. APRA is undertaking a pilot of a new quality assurance framework, designed to provide greater independent challenge and oversight, across selected supervision teams over the next couple of months.

Finally, Recommendation 4 proposes enhanced public reporting on APRA's supervision of the superannuation industry. We agree with this recommendation. APRA is committed to appropriate transparency in relation to its activities and currently achieves this by reporting on its supervisory and regulatory activities by industry in our Annual Report, our publications such as *Insight*, regular appearances before Parliamentary committees, letters to industry and speeches by senior executives. As part of APRA's focus on improving our organisational effectiveness, we established a project in 2014/15 to enhance our internal and external performance reporting, including key performance indicators, with a view to publishing improved performance metrics for 2016/17. This will cover all supervised industries, not just superannuation. As noted above, we wish to move beyond activity measures that focus only on outputs - these are easy to produce but have only limited value in providing meaningful information on the quality and effectiveness of the activities undertaken.

We note that the ANAO report also contains a range of suggestions, as noted in the Annex to this letter. We agree with the suggestions made, and will work to implement them within our broader program of work under our Corporate Plan.

Once again, we thank the ANAO for their insights into our prudential regulation of superannuation entities. Over the last few years APRA has achieved improvements in practices across the superannuation industry, particularly in relation to governance and risk management, through our strengthened prudential framework and robust supervision approach. We are confident that the actions in train or planned as part of APRA's Corporate Plan 2016-2020 will address the ANAO's recommendations and further enhance APRA's supervision of the superannuation industry.

Yours sincerely,



ANNEX

Suggestion	Response
Suggestion 1 (paragraph 2.33) <i>Undertake a review of the appropriateness and effectiveness of its standards and prudential practice guides as soon as practicable and establishing a program to support the ongoing review of standards and prudential practice guides</i>	APRA accepts the suggestion, noting that we are only now getting to the point where a meaningful review might be undertaken (i.e. around 3 years after implementation). We will formalise a timetable for review through our Policy Development area.
Suggestion 2 (paragraph 3.4) <i>Minor improvements to the forms and related guidance material for the licencing of superannuation entities</i>	APRA notes that instructions to lodge other approved forms are not typically included in the content of an approved form. However, APRA will update the instruction guide to provide guidance on lodging the approved forms under s.29C. APRA will also update the webpage on acting trustees.
Suggestion 3 (paragraph 4.13) <i>Adopt a more systemic approach to managing industry wide risk</i>	APRA agrees that opportunity exists to implement a more structured framework for heightened industry risks. We will address this suggestion as part of our strategic initiative to sharpen APRA's risk-based judgements.
Suggestion 4 (paragraph 5.17) <i>Establish a framework to monitor the timeliness of supervision activities</i>	APRA has an established framework for monitoring the timeliness of supervision activities. APRA will be implementing a more effective process for recording and monitoring actions arising from prudential reviews and other supervision activities as part of our Supervision Renewal Program.
Suggestion 5 (paragraph 5.21) <i>Undertaking reviews of entities subject to enforcement action</i>	APRA agrees that reviews of enforcement action can assist APRA to identify areas for improvement in its supervision approach. Reviews are undertaken and the outcomes of such reviews are captured within updates to our supervision and prudential frameworks.
Suggestion 6 (paragraph 5.31) <i>Better specifying key performance indicators to measure the timeliness, quality and implementation of superannuation supervision activities</i>	There are a range of measures that are currently monitored within APRA's supervision divisions. However, these are being reviewed and enhanced as part of work being done to improve APRA's internal and external performance reporting, with a view to producing improved performance metrics for 2016/17.

ANAO comment

Paragraph numbers have changed in finalising the report. Paragraph 5.17 is now 5.20, paragraph 5.21 is now 5.24, and paragraph 5.31 is now 5.35.