

File Name: 2017/07

29 March 2018

Ms Carolyn Morris
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2001

via e-mail to: superannuation.policy@apra.gov.au

Dear Ms Morris,

Re: Consultation on *Strengthening superannuation member outcomes*

The Association of Superannuation Funds of Australia (ASFA) is lodging this submission in response to the consultation on APRA's *Strengthening superannuation member outcomes* proposal.

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its \$2.6 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 14.8 million Australians with superannuation.

General observation

ASFA is appreciative of the opportunity to consult on the *Strengthening superannuation member outcomes* proposal.

ASFA has previously made submissions in response to consultation on the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017*, the Senate Economics Committee review of that Bill, and APRA's *Strengthening operational governance* proposals. We note that APRA has indicated that these submissions will be considered as part of the current consultation and we will avoid repetition unless it is necessary.

However one point that does bear repetition is ASFA's view that the regulatory burden for superannuation fund trustees is already heavy and that any addition to that burden should be made only where it is absolutely necessary. We acknowledge the need for the superannuation system to have a strong regulatory framework and that regulators should have appropriate powers and instruments to ensure that the system is stable, efficient and delivers on its objectives. As we have said before, we are not convinced that all of the proposed measures are absolutely necessary for APRA to perform its functions or that the additional cost of implementing the new measures is justified.

ASFA appreciates that APRA has considered the costs its proposals will bring and has consciously made efforts to simplify and streamline its proposals where possible. However the fact remains that the proposals, especially those relating to the new member outcomes assessments and the additional reporting requirements, will add to the cost and reporting burden which super funds already bear and we are not convinced that the desired benefits will eventuate.

ASFA understands the context in which APRA has put forward the proposed measures but we have reservations about:

- the administrative burden of the annual outcomes assessment, its potential to add a fresh layer of compliance and reporting for trustees, and the role it will play in APRA's overview of funds' performance
- the basis on which comparisons will be made for choice products
- the potential for segmentation of the RSE licensee's membership to add to the administrative burden of conducting the outcomes assessments
- with regard to the outcomes assessment, the potential for tensions to arise between the RSE licensee's statutory or legislative obligations and those imposed by the new prudential standard
- the resource impact and the rationale for the proposed reporting standard.

ASFA welcomes the fact that the proposed outcomes assessment will not be required to be made public.

We also note that APRA has indicated that there will be a further round of consultation for the additional reporting and 'look through' proposals and so we make only general comments in relation to those topics and will deal with the detail of those proposals when it becomes available.

Specific comments

ASFA would like to raise the following issues with respect to APRA's *Strengthening superannuation member outcomes* proposal:

1. Annual MySuper and all beneficiaries or 'choice' outcomes assessment

1.1. *The mismatch between the existing and proposed legislative outcomes assessments for MySuper beneficiaries and that proposed in SPS 225*

The existing 'scale' test (S. 29 VN of the SIS Act) and the amendments to it contained in the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017* (the Bill) require a different assessment from that put forward in SPS 225. The existing 'scale' test requires that a trustee include a MySuper product that 'promotes the financial interests of the beneficiaries' and 'determine on annual basis whether the beneficiaries of the fund who hold the MySuper product are not disadvantaged'. The amendments to S.29 VN in the Bill remove the disadvantage test and replace it with a series of factors to determine whether 'the financial interests of the beneficiaries ... are being promoted by the trustee'.

Given that trustees cannot avoid the requirements under S.29 VN it would appear that for MySuper members they will be required to conduct the existing assessment or the assessment proposed in the Bill and then a second assessment under the different requirements in SPS 225. It would be simpler if the requirements were aligned and that there were only one assessment for MySuper beneficiaries.

1.2. *Overlap between existing trustee covenants and SPS 225*

Trustees are already subject to duties relating to acting in the best interests of members, and investment and insurance covenants under S.52 of the SIS Act. This raises the question of whether SPS 225 aims to change the approach to documenting trustee's compliance with S.52 and/or whether it aims to redefine the scope and application of S.52. We also seek confirmation that a failure to satisfy the requirements or objectives of an outcomes assessment will not constitute a breach under the SIS provisions.

1.3. *How many outcomes assessments will an RSE Licensee be required to produce?*

ASFA acknowledges that the outcomes test proposal leaves the application of the outcomes assessment requirement to the judgment of the RSE Licensee however in practice it is likely that in deciding how to 'segment its business' an RSE Licensee may need to prepare multiple outcomes assessments, each with varying standards, benchmarks and comparison groups. Depending on the size and complexity of an RSE Licensee's business it is easy to imagine four or five different outcomes

assessments and the potential for more. The greater the number of outcomes assessments the greater may be the burden on fund costs and resourcing.

1.4. Comparability and the difficulties in making comparisons between 'choice' products

How are qualitative measures to be defined?

ASFA has previously argued that 'choice' products have a great variety of product features and member benefits attached to them and it is difficult to compare them directly, especially with regard to net returns alone. There are also a variety of elements from which choice members derive value which introduces a significant qualitative element to the outcomes assessment. It should also be recognised that 'choice' members often exercise choice in a broader investment portfolio context, which may not be visible to the fund or the regulator, and the proposed outcomes assessment cannot take account of decisions made by individuals in this position.

We acknowledge that the proposed outcomes assessment does not target net returns solely however we question how the value of benefits such as brand affiliation, trust, service, range of services, security and modern technology is to be calculated as these benefits can for the most part only be judged using qualitative and subjective measures.

We also note that SPS 225, clause 8 (d) (i) requires the calculation of the metrics for internal and comparative purposes 'with reference to **objective** benchmarks and targets'. This would appear to limit, if not exclude, qualitative assessment and if so we recommend it be reworded.

Appropriate basis for comparison

It is not clear how many funds should be used as a point of comparison and it should be noted that any comparison could only use publicly available information which may not provide a full picture, and therefore result in a compromised comparison. This is particularly relevant to the requirements in draft SPS 225 clause 8 (e) (iii) and (v) relating to 'facilities' and 'significant fund expenditure' for which public information may be limited.

The approach to segmentation of the 'choice' membership will also affect the approach to making comparisons and determining appropriate benchmarks and metrics and it is readily conceivable that different choices made by otherwise comparable funds could lead to very different bases for comparison. For example an RSE licensee who segments by age-group will look very different from one who segments by gender or occupational category.

For the reasons outlined above, any outcomes assessment will comprise an amalgam of different measures with different weightings from other assessments and this will mean that APRA will need to take care in comparing outcomes assessments between RSE licensees.

We seek further information about how the outcomes assessment is to be applied to defined benefit funds and closed legacy products where comparisons may be difficult. We also seek further information about what is meant by a 'longitudinal' review and what the particular requirements of such a review might be.

The Choice Dashboard

Proof of the difficulties in making comparisons between choice products is shown by the delays in the release of the choice product dashboard requirements. The choice dashboard was originally due to be made a requirement for RSE licensees in 2014 and since then its release date has been pushed back, currently to 2019. These delays are almost certainly due to the complexity and difficulties of designing a basic comparison schedule for the various choice products available to consumers.

Insurance

ASFA regards the requirement to make an annual comparative assessment of insurance benefits as excessive, except at a superficial or desktop level. A thorough comparative review of insurance benefits, usually undertaken at the time of issuing a tender, can be a costly and time-consuming business usually involving an external consultant, and it does not make sense for such a thorough review to be conducted on an annual basis. ASFA recommends that this requirement be left to the discretion of the RSE licensee or the degree of detail required be defined in the standard or guidance.

1.5. Timing for the outcomes assessment

A number of ASFA members have said that they would rely on APRA's superannuation statistical data to conduct an outcomes assessment and that any delay in the release of this information, such as has occurred this year, will affect their ability to complete an outcomes assessment in time for the inclusion of its results in their business planning activities and setting of strategic objectives.

We note that APRA has advised that RSE licensees will have 12 months from 1 January 2019 to complete their first outcomes assessments.

1.6. Self-assessment v. APRA's assessment

ASFA notes that the outcomes assessment is designed to encourage trustees to assess their own performance, make improvements where necessary, or decide to wind the trust up in some form if improvements are not possible. However we also note, as described above, that the outcomes assessment offers trustees a fair degree of latitude in its application and in its interpretation while at the same time APRA has its own internal standards and yardsticks for what constitutes a strong or poorly performing fund. These would appear to be principally:

- Net cashflow ratio distribution over the last three years
- Cost per member vs MySuper net returns over the last three years
- Operating expenses vs current cashflow ratio
- Change in membership and active member ratios.

These were set out in APRA's letter of 31 August 2017 to RSEs and it was presumably on these measures that APRA identified the poorly performing funds that it announced it would approach to 'develop robust and implementable strategies to address any weaknesses or prepare for the transfer of members to another fund'.

While this is not new, the all beneficiaries or 'choice' assessment makes the potential for divergence between a trustee's self-assessment and APRA's assessment substantial. APRA should recognise that trustees can only deal with the prudential standards as they are defined and while meeting community expectations, providing value for money or delivering satisfactory member outcomes should be the aim of all RSE licensees, they are also open to a variety of interpretations and definitions.

ASFA is also of the view that the standard APRA wishes to apply is very high, rigorous and potentially difficult to meet. Our concern is not so much with the intent, but with the prescriptive way funds are being asked to reach conclusions; that APRA's views of strategic and business planning are quite rigid and do not reflect either the increasingly dynamic environment funds work in or modern practices.

Further, we note that APRA wants to review absolute performance up to or beyond targets and comparative outperformance, and that 'even where an RSE licensee's metrics compare favourably to objective benchmarks and the performance of other RSEs, ... an RSE licensee would assess whether it is able to improve on these outcomes' (p. 11 Draft SPG 225 – Outcomes Assessment, December 2017). While ASFA does not argue against RSE licensees always looking for ways to do things better it is a challenging yardstick to apply when measuring results or performance.

1.7. Requirement to determine whether future outcomes could be improved

Clause 6 of SPS 225 imposes a requirement on trustees to make the outcomes assessment and 'determine whether future outcomes could be improved through changes to ... business operations'. While ASFA supports ongoing improvements to business operations, we are concerned that this test could be difficult to define or applied inappropriately or narrowly.

As described above, how is it to be applied where an RSE licensee has met its targets and outperformed its competitors? How would APRA assess a well-performing RSE licensee who makes or identifies less 'improvement' over time than a poorly-performing RSE licensee who makes or identifies significant improvements?

ASFA is of the view that a requirement to identify 'improvements' is subjective and open-ended and while we support the concept we consider it to be difficult to measure and potentially challenging for an RSE licensee to establish.

2. Strategic and Business Planning

ASFA's position with regard to the business planning requirements, expressed in our previous submissions, remains unchanged but we welcome the opportunity to make a few additional observations.

2.1. *Timeframe for strategic objectives*

The applicable timeframe for 'strategic objectives' is not defined and is likely to be interpreted differently by RSE licensees.

One potential interpretation of the requirement for business planning to be on a three year rolling basis is that strategic objectives should also be set on a three year rolling basis. This is a short timeframe for some initiatives whose benefits may take time to bear fruit.

On the other hand the requirement for the outcomes assessment to be conducted annually and its results incorporated annually in business planning suggests that strategic objectives might be limited to one year.

ASFA would prefer it if the wording was redrafted to demonstrate that the timeframe for strategic objectives is to be determined by the RSE licensee and not limited or defined by the business planning requirements prescribed by the prudential standards.

2.2. *The business plan should be able to comprise multiple documents*

The proposed SPS 220 defines in some detail what must be in a business plan but the SPG indicates that it does not have to be in one single document. ASFA recommends that the SPS be redrafted to provide flexibility so that the multiple business policies and documented frameworks, processes and policies which relate to the business plan do not have to be duplicated in a single business plan document.

Business plan - assessment of performance and setting measurable targets APRA's theoretical strategic and business planning framework is based on the idea that a business sets strategic objectives, this is supported by a business plan with appropriate and measurable targets to achieve those objectives, and performance against the outcomes is monitored and adjustments made if required. In reality, there are always challenges in running a large commercial enterprise and there is always potential for unexpected events to disrupt this neat 'set, deliver, measure and adjust' model.

ASFA supports the setting of 'measurable' strategic objectives and business plan targets but we are concerned at how APRA will deal with the failure of a business to meet one or more of those targets. There may be very good reason for a business to fail to meet one or more of its business plan targets. For example: deferral of a project due to unexpected demand on resources in other parts of the business; an inherently risky digital or innovation project may fail to deliver the anticipated benefits; or

it may be inappropriate to impose hard targets or deadlines for long-term and complex projects such as an IT administration or data migration.

ASFA is of the view that assessing a business plan requires sensitivity, a sense of proportion, and an acceptance of the fact that failure to meet certain targets is not an automatic cause for concern. We are also concerned that a strict pass or fail approach to business plans and their internal measures could lead to a culture of risk avoidance among RSE licensees at the expense of investment in sensible but potentially risky projects which could ultimately lead to better services and results for superannuation fund members.

2.3. Business plan timing

As flagged above the requirement to incorporate the impact of the outcomes assessments on strategic objectives in a business plan introduces a timing risk. A number of our members have indicated that business and strategic planning normally commence early in the calendar year and conclude towards May to early June. If APRA's statistical data are not available in time it will be either difficult to incorporate this information or it could delay the development of the business plan. If existing business planning timing is even earlier (December – February in some cases) then the results of the outcomes assessments might have to wait for the following year's business plan before they can be incorporated.

2.4. Business cases for significant expenditure

The requirement to make a business case for any significant expenditure raises the question of what 'significant' means under this requirement. While we do not seek a prescriptive definition it would be beneficial if further explanation could be provided as to what is intended to be captured under the term 'significant'.

Concern has also been raised about the level of prescription in the design of the business case. Most businesses have an existing business case template and process and it could be costly to require RSE licensees to recast their business case processes to meet the precise criteria set out in SPS 220.

APRA should also note that a positive business case result ought not oblige an RSE licensee to make an expenditure. It is easy to envisage scenarios where an RSE licensee is unable to proceed with a project due to competing or unexpected demands on its resources even though the stand alone business case suggests that the proposal has a positive rating and would be beneficial.

2.5. APRA's policy options and estimated comparative benefits

ASFA welcomes APRA's attempt to look at the net costs and benefits of its own policy proposals (Attachment B – Policy options and estimated comparative net benefits, *Discussion Paper Strengthening member outcomes*). However we would like to point out that it is too early to estimate

the costs of the proposals, especially those to be borne by RSE licensees, due to the lack of detail for many of the proposals. The assessment in Attachment B also does not seem to meet many of the criteria set out in the business case requirements in SPS 220.

2.6. The requirement to implement a ‘management information system’ to measure, assess and report on all material risks

The scope of this requirement is unclear. If it is intended that strategic risks are intended to be captured in addition to operational risks there may need to be significant changes to existing systems and practices and we would welcome a clarification about the intended scope of this proposal.

2.7. Appropriateness of strategic objectives and business planning under the risk framework

We are concerned that APRA is proposing to expand the strategic objectives and business planning requirements through the risk framework, instead of developing a specific standard or guide. We understand that APRA is seeking to work with industry and has taken this approach to avoid proliferation of guidance and standards.

The Risk standard is already far reaching and is not an obvious home for the additional strategy and expense management requirements. Our considered view is that positioning funds’ strategic and business planning processes under the risk framework implies that Risk Departments will be signing off strategic plans, KPIs, member outcomes and performance reviews. This suggests that risk should be the primary consideration in strategic and business planning and takes the reach of Risk Departments well beyond common understanding of how both Strategic Planning and Risk Departments work. Our recommendation is for APRA to consider a separate standard.

3. Reporting proposals – Expenditure and reserving

ASFA acknowledges that there is to be a separate round of consultation for the RSE licensee level reporting, ‘look through’ and other related proposals however we would like to make the following general observations:

- The rationale for the look-through and RSE licensee level reporting needs to be explained.
- The level of detail APRA expects under the look-through and RSE licensee level reporting proposals needs to be defined. The level of detail will determine the degree of changes required for administration and reporting systems and the cost of making those changes.
- Some funds consider that it would take up to two years to accommodate significant changes to the existing reporting standards. The transitional arrangements for the increased reporting will need to allow for these potentially significant system changes.

- The cost of the additional reporting needs to be weighed against the supposed benefits before any decision is made to impose them. Once the detail of the proposal is defined APRA should conduct a business case in line with its requirements for RSE licensees who undertake 'significant expenditure'.
- Some outsourced services are bundled and unbundling the components would require the cooperation of the outsourced provider and potential changes to the contract. There may also be confidentiality issues for the outsourced provider.
- How will the new reporting requirements fit into the D2A replacement project (Athena) and will APRA ensure that any additional data requirements are synchronised with that project to minimise fund project costs?

4. Insurance opt-out

4.1. Simplifying mechanisms for opting out of insurance

ASFA supports the proposed change to SPS 250 but we urge any further consideration of this topic to be delayed while the Voluntary Insurance in Superannuation Code of Practice is still in the process of being adopted.

ASFA is confident that the Code will lead to significant improvements to the provision of insurance through superannuation. We consider it should be given time to be implemented before any significant review of the insurance prudential standard.

Conclusion

In general, ASFA is cautious about any reforms which add to the regulatory or reporting burden for its members without a clear purpose or benefit first being established.

We can see merit in the spirit of some of the proposed reforms, however we have reservations about the impact on resources that proposals like the outcomes assessments will present for RSE licensees.

While we appreciate the intent behind the outcomes assessment proposals we are concerned that it will become primarily an additional and substantial compliance exercise. We question whether APRA could achieve the same result with its existing regulatory and supervisory powers without imposing a blanket requirement on all RSE licensees.

We are also concerned that the prescription in the strategic objectives and business planning doesn't recognise the flexibility required by a modern commercial business and that the general effect of the proposals may be to make RSE licensees more cautious and risk-averse in their strategic business planning and objective setting, or to treat risk as a primary consideration.

We would like to thank you for the opportunity to provide comments on the *Strengthening member outcomes* proposals.

Should you have any questions on any of the matters raised in this submission please do not hesitate to contact me on (02) 8079 0808 or gmccrea@superannuation.asn.au or Byron Addison on (02) 8079 0834 or baddison@superannuation.asn.au.

Yours sincerely

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