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Mr Pat Brennan
General Manager, Policy Development
Policy, Statistics and International Division
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Email: regulatorycostsavings@apra.gov.au

Dear Mr Brennan,

CONSULTATION ON UPDATE ON REGULATORY COSTS SAVINGS – FEBRUARY 2015

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to APRA's request for feedback from industry on the set of options presented in the *Update on regulatory costs savings* paper (the "Paper") and proposals for any further cost saving options.

About ASFA

ASFA is a non-profit, non-politically aligned national organisation. We are the peak policy and research body for the superannuation sector. Our mandate is to develop and advocate policy in the best long-term interest of fund members. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90 per cent of the 12 million Australians with superannuation.

A) Feedback on the set of options presented in the *Update on regulatory costs savings* paper

ASFA appreciates APRA's consideration of potential ideas where costs could be saved by APRA and industry alike, and in particular the initiatives noted by APRA in chapter 2 are commendable.

We would encourage APRA to complete its review and to implement appropriate changes in a timely manner to ensure that cost saving opportunities are achieved as soon as possible and are thereby maximised.

1. Review of board requirements

The Paper indicates that a review of the clarity of APRA's requirements for boards, contained in prudential standards and supporting guidance materials, would be conducted for the superannuation industry in due course.

ASFA strongly supports such a review taking place. Clarity about the requirements will lead to some cost savings and, more importantly, will improve member outcomes.

2. Review of audit requirements

The Paper identified that a review of audit requirements would be an area where significant cost savings may be achieved through reducing: -

- the coverage of prudential matters by auditor assurance and focussing on key areas; and
- the frequency of audit for routine reporting.

ASFA agrees that greater reliance on internal audit as opposed to external audit would generate significant cost savings, not only in audit fees but also in indirect costs. If amendment to the audit requirements were introduced costs savings for members will occur with almost immediate effect.

Reporting to APRA is subject to a duty of care to ensure accuracy. Reductions in the scope of some of the audit requirements need not compromise the soundness of the prudential framework or affect regulatory oversight.

3. Review of offshoring consultation requirements

ASFA supports exempting from the offshoring consultation requirements (*Prudential Standard CPS 231 Outsourcing)* investment management agreements with offshore investment managers where:

- the assets are subject to Australian custody; or
- an offshore custody arrangement has already been assessed by APRA.

In these circumstances there is no new material offshoring risk.

4. The reporting framework

ASFA has received feedback from members with respect to APRA's data reporting framework, in particular the costs necessitated by the volume and detail of data items; the frequency of reporting; the relatively short time frames for lodgement after period end; the processes for validations and queries and the D2A system.

4.1 Proposals for review

ASFS supports the proposal for APRA to consider extending the review of both non-prudential data and data which is used for APRA purposes only. We would advocate that these reviews occur as soon as possible.

ASFSA members have indicated that amendments to the reporting framework to reduce the detail of some reporting forms, reduce the frequency of some reporting and extend some reporting timeframes would be beneficial and would serve to reduce costs.

A number of members have indicated to ASFA that amendments to reporting of data to APRA are their highest priority.

4.2 Timeframe and frequency of reporting

Some trustees of superannuation funds have indicated that they will have approximately 1200 reports to be made per annum, with most of these being Select Investment Option ("SIO") reports, and yet they have only 28 calendar days (20 business days) for quarterly submissions.

It has been suggested that many quarterly reports could be annual with little to no change in prudential value. By way of example, defined benefit reporting rarely changes from one quarter to the next.

There is an argument that, with respect to some forms at least which have lesser prudential value, as perhaps they vary little from quarter to quarter, the fourth quarter report could be dropped, given that the annual report will be made shortly after. For other forms, where the fourth quarter reflects that year, the annual report could be dropped.

Further, we understand that there have been occasions where legitimate differences between the fourth quarter report and the annual report, due to timing issues, incorrectly have been perceived to be errors by APRA, leading to suggestions that the fourth quarter report should be resubmitted.

4.3 Need for business days and for longer periods for reporting

Stipulating the timeframe for quarterly reporting as calendar days, as opposed to business days, is problematic in that it fails to recognise public holidays.

By definition businesses only have business days in which to perform tasks without necessitating people having to work outside their ordinary hours of business, potentially resulting in overtime \ penalty payments or time in lieu obligations. This is how the concept of a "business day" came about.

April frequently has three public holidays which fall on a week day, which has the effect of reducing the time available from 20 business days to 17 business days. This represents a reduction of 15 per cent in the number of days available to perform the necessary tasks – a material reduction. Similarly, January often has two public holidays falling on a week day, which represents a reduction of ten per cent in the number of days available.

Furthermore, while we welcome the cost efficiencies which have been achieved by temporarily allowing an additional seven calendar days (five business days) for quarterly reporting lodgements, we consider that the extension to 35 calendar days (25 business days) should be extended. Changes to forms are still occurring and new forms with respect to SIO reporting will be coming on line, significantly increasing reporting volumes. Many funds will incur significant additional costs to enhance their technologies and processes in order to shorten their reporting cycle time in time to lodge reports with respect to the September 2015 quarter.

We believe that the 28 calendar day (20 business day) timeframe will continue to remain an issue across the superannuation industry given: -

- the number of reports to be provided;
- the level of detail required;
- the volume and diversity of investment data to be collated, derived and reconciled; and
- the need to liaise with third part service providers such as custodians and administrators.

Generally there is a single, dedicated team which performs the task of reporting data to APRA. In accordance with the paradigm that – where the scope and timeframe are fixed – the only factor which can vary is cost, the relatively short time frame serves to increase costs materially.

Further, not only does the short time frame serve to increase costs but places inordinate pressure on the APRA data reporting team, processes and systems and significantly increases the risk of error, necessitating otherwise unnecessary re-work on the part of both APRA and the superannuation fund. Allowing a longer period would improve the quality and integrity of the data reported.

Accordingly, ASFA requests that APRA: -

- specify the period for reporting in terms of business days as opposed to calendar days; and
- extend the period to: -
  - 30 business days for the first three years of a particular form; and
  - 25 business days thereafter.

ASFA seeks APRA's further engagement with the industry to explore the underlying issues, including the possibility of considering alternative approaches such as staggering timeframes across different quarterly reports, as a function of their prudential significance; reducing the frequency of some quarterly reporting to annual reporting and possibly reducing the number of data items by removing some non-essential items.

4.4 Review of practices and procedures generating validations and queries on prudential returns

ASFA members have indicated that improving APRA's data queries process would reduce significantly the time and costs incurred in responding to queries. In particular the tolerance ranges, whereby data which falls outside the expected range and generates a validation query, often appear to be too specified too narrowly. The mains issue is with respect to dealing with queries post submission, as opposed to preparing D2A returns.

The industry has a general understanding of the use of errors and validations, which it employs in its business practices, processes and procedures. While increasing the transparency of APRA's error and validation processes may marginally improve understanding, the main issue issues are the number of validation generated queries received. Accordingly, ASFSA supports the need to perform systematic and ongoing reviews, to ensure that superannuation funds are required to provide explanations only where necessary and to ensure that the validation rules only identify errors and do not generate a high rate of queries requiring an explanation where the data is not in error.

4.5 Improve consistency of APRA reporting with accounting standards & other agency reporting

ASFA agrees that greater alignment with other regulatory reporting requirements, such as the Australian Accounting Standards, and reduced duplication of reporting which occurs to other agencies would be highly desirable.

In particular it has been suggested that data which is reported to the Australian Taxation Office for the Australian Bureau of Statistics effectively duplicates some of the data which will be reported on SRS 730 (overseas members) and some of the SRS 610 series regarding membership profile (for example, unique TFN).

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4.6 The D2A system

ASFA members have significant concerns about the D2A system. In particular, the user interface is not use friendly as it does not allow uploading of data but instead necessitates manual data entry be performed. We note that APRA has indicated that it considers the future life of D2A to be limited and we strongly support the need to investigate potential replacement systems for D2A as a priority.

4.7 Deferral and re-consultation on select investment option reporting

Following the recent announcement of the withdrawal of SRS 702.1, pending further consultation, we believe further efficiencies could be achieved through enhancing the consultation process.

By way of example, the potential exists to realise significant efficiencies by forming a representative industry working party, composed of industry associations, custodians and administrators and some individual superannuation providers, during the development stage of a consultation process. This would serve to expedite stakeholders' shared knowledge with respect to the implications of applying a proposed standard to different RSE functional models within the industry (including wrap platforms and master trusts). If stakeholders gain a thorough understanding early in the development stages of new or revised SRSs, issues with respect to the application of SRSs to different models can be more readily dealt with during the consultation process.

5. Review of aspects of the operational risk financial requirement (ORFR) for RSE licensees

The Paper states that: -

> *"Submissions also suggested that the application of a materiality threshold when charging operational risk losses against the financial resources held to meet the ORFR under SPS 114 would generate significant savings. APRA will consider the potential application of a materiality threshold over 2015.*[1]

ASFA welcomes the opportunity to collaborate further with APRA on the ORFR and we reiterate our prior submission to APRA that being compelled to utilise the reserve in the execution of normal business processes would significantly increase the costs associated with utilising the ORFR reserve without enhancing the level of member protection provided.

5.1 Materiality threshold when charging operational risk losses against the ORFR

In general, entities ensure that the amount required to be maintained as a reserve remains available on an on-going basis. Often the reserve is simply the "balance of the revenue account" with no special accounting requirements.

When an error or operational risk event occurs, or if compensation otherwise is payable, this is simply treated as a business expense of a service provider. This additional expense is a charge against the service provider's profits - if profits go negative the capital available to meet the statutory reserves is reduced accordingly. In an extreme case the company may cease trading. There is no requirement to use a specific reserve to meet such an expenses - the only requirement is to demonstrate that the reserve continues to be available.

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[1] Page 12

The ORFR requirements for RSE Licensees are substantially different from the capital requirements for other APRA regulated entities. In particular, the effect of SPS 114 is to require every loss arising from the occurrence of an operational risk event to be charged against the ORFR reserve, regardless of the materiality of the loss.

SPS 114 necessitates that: -

- the amount of the reserve must be set aside with identifiable assets and a clear investment policy;
- the magnitude of the reserve may vary from the target (within tolerance limits);
- a formal top-up process is required such that extra capital is provided if the reserve reduces below the threshold; and
- the reserve should operate on an ongoing basis to compensate for operational losses and would subsequently be required to be "topped-up".

All of these differences add cumulatively to the cost of maintaining the ORFR: -

- for the first three items the additional costs are relatively small and mainly relate to the establishment of a trustee framework. They do, however, introduce complexity, particularly with respect to a diversified institution comprised of other APRA regulated entities holding regulatory capital. This complexity requires additional training and a higher degree of proficiency and capability to manage the different processes associated with maintaining the separate reserves;
- for the fourth item there are substantial set up costs, as well as on-going costs. These costs are significantly increased every time the ORFR is required to be utilised.

Furthermore, reimbursement of an operational loss by third party service providers, such as an administrator or custodian, can only be effected through first replenishing the ORFR reserve. Consideration should be given to providing an allowance for third parties to compensate members for a loss arising from the occurrence of an operational risk event directly, as provided for in compensation arrangements negotiated and agreed between trustees of superannuation funds and third party service providers, with an appropriate materiality threshold. When a service provider agrees to remediate members for an operational loss, the approach is to correct the error and treat all remediation costs as an expense. This approach requires no extra accounting or decision making and hence no additional expense. This approach is in line with that adopted by other APRA regulated entities.

Prior to the commencement of SPS 114 there were processes and financial resources in place to remediate losses arising from the occurrence of an operational risk event, such as an administrative error, and to ensure members were compensated promptly.

Where the fund was self administered the costs would comprise part of the normal operating costs of the fund which were balanced periodically and which was were recovered through the administration fees charged to members. Where the administration function was performed by an external service provider, the service provider would remediate members directly and the costs of so doing would be borne by the service provider and accounted for as part of their operating costs.

Neither case necessitated a special accounting treatment and there was a common way in which to treat all compensation expenses. Transparency around the compensation of losses arising from the occurrence of an operational risk event would be provided through the internal reporting of events and reporting from the third party service provider to the trustee. In the case of significant loss events often an independent consultant would be appointed to provide oversight and ensure the probity of the process. The compensation of losses arising from an operational risk event could also be subject to audit and review.

The requirement that the ORFR be used as the source of funds to remedy all operational events necessitates work to: -

1. develop a new set of accounting processes and procedures;
2. run the new and old processes in parallel;
3. decide, with respect to each instance of compensation, which process to follow. In the absence of a materiality threshold this decision will need to be made in every instance - in many cases it is not immediately apparent whether it would be appropriate to use the ORFR;
4. on occasions, charge some expenses against the ORFR and some against normal operating expenses – that is, both procedures may need to be utilised; and
5. report to APRA where the ORFR is used - an additional layer of reporting.

Significantly more work is required to create the necessary accounting entries; to move funds from the ORFR to an operating account and then back again, in the decision making process and in APRA reporting.

The volume of additional work would be more manageable if the approach to using the ORFR were by exception, because this would necessitate fewer accounting entries which could be posted manually. In addition, significantly less work would be required if there were no requirement to align the error reporting and accounting systems.

If, instead, every operational risk event must be remediated using the ORFR then it will be necessary to introduce a robust and systematic process which will need to be accessed and used by a wide range of staff. Such a system would, of necessity, be complex in its requirements, including: -

- the interface and reconciliation of the error reporting and accounting systems;
- the interface and reconciliation of the remediation amounts with ORFR accounting;
- a widespread decision making process with respect to the use of the ORFR;
- extensive staff training to distinguish errors to which the ORFR applies from those to which it does not; and
- separate accounting for different types of errors and expenses.

ASFA believes that the implications of utilising the ORFR in all circumstances would require significant increases in the establishment and ongoing operational costs, without enhancing the level of member protection provided.

The annexure to this submission contains a table which provides a “top-down” estimate of the potential savings for one large superannuation provider which may be generated from the introduction of a materiality threshold if the ORFR were set at $500, 000.

Furthermore, for diversified institutions which are comprised of a number of different entities which maintain regulated reserves (for example, an ADI; life company and a superannuation fund) it would be preferable to be able to utillise similar procedures across all environments.

For reserves maintained by ADIs and life companies there is no explicit requirement to use the reserves. Instead, by way of contrast with superannuation, the remediation of losses causes by the realisation of an operational risk forms part of general expenses - the only requirement is to ensure that the required level of reserve is maintained, which generally is managed as the balance of the revenue account. In other words, the reserve is only used when absolutely necessary.

In light of the above, ASFA believes that requiring the ORFR to be utilised regularly will increase substantially the on-going running costs for the remediation of operational risk losses.

In order to reduce this unnecessary regulatory cost for the industry (and members) ASFA believes that the ORFR should only be required to be utilised when the Trustee needs to do so (that is, to fund payments arising from material events where an external service provider, or an insurer, is unwilling or unable to pay). We believe that this is consistent with the approach adopted with respect to other regulated entities, such as ADIs and life companies.

As a next best alternative - to reduce these costs across the industry – ASFA would strongly support the introduction of a materiality threshold which will ensure that the ORFR is only utilised and reported upon only for materially significant events or in circumstances where the trustee needs to utilise the reserve.

5.2 Scope of yearly review of ORFR target and tolerance limits

ASFA believes that the value of performing a full annual review of the ORFR would be minimal because: -

- reserves generally are needed only to meet an exceptional operational risk event. On a year by year basis very little new information becomes available to quantify such events; and
- the operations of a superannuation fund evolve slowly, so in most cases the basic operations and risk of an adverse operational event will not have changed substantially. If a major operational change were implemented then this would serve to suggest that a full review may be valuable.

A full review of the ORFR target and tolerance limits would necessitate: -

- an analysis of all previous years' loss events;
- an analysis of all available history; and
- an analysis of what industry data is available.

This analysis would involve sophisticated statistical and qualitative elements. The level of specialist expertise required to perform this work is considerable, is unlikely to be readily available and would in all likelihood need to be acquired at significant expense.

B) Some proposals for further cost saving options

1. Reporting of SRF 330 Statement of Financial Performance

The provision of an allowance to report transaction types on the basis of a reasonable estimate, or by apportioning member-level data, would significantly reduce the costs of regulatory compliance.

This potentially could include the reporting of: -

- member/employer contribution types;
- benefit payments;
- insurance related inflows/outflows; and
- income tax expenses/benefits

(Items 1, 2, 8 and 10 of SRFs 330.1/330.2).

An allowance to report the nature of employer contributions (item 1.1 in SRF 330.0) and SMSF rollovers (item 2.2.1 in SRF 330.0) on a best endeavours basis would also provide significant benefits.

Financial ledgers are the primary source of data for the SRS 330 series of reports. Certain data attributes are not available from the ledger (e.g. the destination of a rollover; the type of employer contribution) and must be supplemented with information obtained from the registry system.

A number of registry systems had no need to maintain some of the data attributes imposed under APRA reporting. By way of example, a registry system maintained for individual retail superannuation needed only to differentiate between member and employer contributions. The task of collecting and maintaining record keeping of further breakdowns of employer contributions between “Superannuation Guarantee” and “salary sacrifice” contributions, purely for the purpose of APRA data reporting, necessitates incurring unnecessary costs which ultimately are borne by members.

2. Superannuation Defined Benefit Reporting

APRA plays an important part in the oversight and prudential supervision of defined benefit (“DB”) arrangements.

Prudential Standard SPS 160 prescribes a clear framework to help ensure RSE licensees appropriately manage these DB arrangements to ensure they meet the liabilities of the fund as they fall due. Importantly, SPS 160 requires RSE licensees to provide timely notification to APRA in the event that a DB arrangement is found to be in an unsatisfactory financial position and to undertake certain actions towards restoration to a satisfactory position.

Separately from the obligations imposed under SPS 160, RSE licensees are also required to lodge various annual and quarterly reporting with respect to DB arrangements under various APRA Superannuation Reporting Standards.

The obligations of notifications under SPS 160 and reporting under the reporting standards are duplicative and, in combination, unduly burdensome.

Case Study

For illustrative purposes, we have provided a case study supplied by one of our RSE licensee members to demonstrate the volume of DB reporting over a 12 month period.

- a single RSE licensee with
  - a single master trust RSE with 47 DB sub-funds; and
  - three other RSEs each with a DB sub-fund;
- three DB sub-funds notified to APRA as being in an unsatisfactory financial position ("UFP")and undertaking a restoration plan;
- total number of DB members across the four RSEs = approximately 5,000;

The table below indicates the volume of APRA SRFs with DB data submitted over a 12 month period:

SRF	Type	Name	Units *	Quarterly	Annual	Total p.a.
114.1	RSE	ORFR (RSE)	4		1	4
160.0	RSE	Defined Benefit Matters	4		1	4
160.0	DB Sub-Fund	Defined Benefit Matters	50		1	50
160.1	RSE	Defined Benefit Flows	4	4		16
160.1	DB Sub-Fund	Defined Benefit Flows	50	4		200
320.1	DB Sub-Fund	Statement of Financial Position	50		1	50
330.1	DB Sub-Fund	Statement of Financial Performance	50		1	50
610.0	RSE	Membership Profile	4		1	4
		Total per annum				**378**

We make the following observations with respect to the above case study: -

- The volume of DB sub-fund reports appears to be disproportionately high, having regard to the number of DB members, when compared with APRA reporting covering defined contribution members. Given the relatively small proportion of the private sector workforce covered by DB arrangements this comparison would be similar across the broader industry;
- Although this is not evident from the above table, there is a duplication of data items within certain of the high volume reports. By way of example:
  - SRF 160.1, item 3.2.1 is duplicated in SRF 330.1;
  - SRF 160.1, item 4.1 is duplicated in SRF 114.1;
  - SRF 320.1, item 4 is duplicated in SRF 160.1; and
  - SRF 320.1, items 5.1 and 5.2 are duplicated in item 7 of SRF 160.0.
- The table does not include updates provided to APRA for DB sub-funds that are in an UFP. These updates generally are provided to APRA at least quarterly meaning that, with respect to these DB sub-funds, there are 12 additional instances of providing information to APRA in a given 12 month period.

We note that the stated purpose of for each of the SRSs for DB sub-funds (160.0, 160.1, 320.1 and 330.1) is *"for the purposes of prudential supervision and publication".* ASFA believes that the prudential supervisory purpose could still be served if APRA were to reduce the volume of reports over a 12 month cycle taking into consideration the separate obligations under SPS 160.

Accordingly, ASFA recommends that: -

- APRA examine the entire framework of DB notification and reporting obligations with a view to assessing whether the cost of compliance (ultimately borne by members) is balanced with its prudential supervisory objectives;
- the reporting periods and due dates of SRF 160.1 be modified to only require submission of the form on a quarterly basis where an RSE licensee has notified APRA under SPS 160 that the DB sub-fund is in an UFP. In all other cases an annual submission only would be required. Quarterly monitoring of UFP DB sub-funds is appropriate and desirable, however, quarterly monitoring of all DB sub funds is not warranted. If this "by exception" approach were to be adopted, the volume of SRF 160.1 forms submitted over a 12 month period would reduce from 200 to 59 (i.e. three DB sub-funds quarterly plus 47 sub-funds annually in a given 12 month period). This represents an overall reduction in volume of 37%.

* * * * *

We would be pleased to meet with you to discuss the contents of this submission.

If you have any queries or comments regarding the contents of our submission, please contact me on (03) 9225 4021 or 0431 490 240 or via email to fgalbraith@superannuation.asn.au.

Yours sincerely,

Fiona Galbraith
Director, Policy

Annexure
Operational Risk Financial Reserve (ORFR) - Potential materiality threshold - cost effect

An ASFA member has provided the following information with respect to the potential cost savings which could be realised as a result of introducing a materiality threshold to the utilisation of the ORFR.

This member is a single service provider with multiple RSE licensees and RSEs. The operations of these RSEs are supported on multiple technology platforms (six registry systems) all connected to a complex web of interfacing systems, multiplying the complexity and cost of developing compliant solutions. On-going costs are substantially increased by the volume of usage, on-going training required for more staff, the volume of documentation which must be produced for each event and the level of automation.

The figures provided, and apportionments to activities, are indicative only and are based on a broad set of assumptions. Substantially more work would be necessary to understand the full implications and determine the specific cost and apportionments.

1.1	$500,000 Materiality Threshold	• The ORFR is only used to compensate members if the total value of a single operational risk event exceeds a materiality threshold of $500,000. • Formal consideration and utilisation of ORFR for an event below materiality threshold limited to where service provider unwilling or unable to reimburse in timely fashion.	
2.	**No. of institutions affected**		
2.1	Three (3) RSE Licensees		
3.	**Activities**	**Upfront cost impact**	**Ongoing costs per year**
3.1.	**Reporting** (10%)	**$2,100,000**	**$182,500**
3.2.	**Staff training** (15%)	**$3,150,000**	**$273,750**
3.3.	**Approval** (5%)	**$1,050,000**	**$91,250**
3.4.	**Purchasing** (60%)	**$12,600,000**	**$1,095,000**
3.5.	**Record keeping** (1-2%)	**$315,000**	**$27,375**
3.6.	**Enforcement** (1-2%)	**$315,000**	**$27,375**
3.7.	**Publication & documentation** (1-2%)	**$315,000**	**$27,375**
3.8.	**Procedural** (5%)	**$1,050,000**	**$91,250**
3.9.	**Other**		
3.10	**Total**	**$20,895,000**	**$1,815,875**
4.	**Total cost savings for one entity after 1 year roll-out**	**($20,895,00 + $1,815,875) = $22,710,875**	