

**Australian Prudential Regulation Authority**

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27 April 2016

Superannuation  
Productivity Commission  
Locked Bag 2, Collins St East  
Melbourne VIC 8003

Dear Sir/Madam

**Superannuation Efficiency and Competitiveness  
Productivity Commission Issues Paper**

Thank you for the opportunity to provide the attached submission in response to the Productivity Commission's Issues Paper.

APRA welcomes the Productivity Commission study to develop criteria to assess the efficiency and competitiveness of the superannuation system. An efficient and competitive superannuation system should lead to enhanced retirement outcomes for members.

As noted in APRA's submission to the Financial System Inquiry, given the varying needs and retirement objectives of individual members, there is no single "best" outcome or approach that would be expected to deliver appropriate net retirement outcomes for all members across the superannuation system as a whole. An appropriately broad assessment therefore necessarily involves both qualitative and quantitative assessment approaches and measures, which is consistent with the broad approach proposed by the Productivity Commission for development of assessment criteria.

APRA notes that it is challenging to undertake meaningful comparisons of RSE licensees, funds and products offered within the superannuation system for a range of reasons. These include deficiencies in the quality and consistency of available data, as well as the complexity of structures and arrangements within the superannuation system.

The attached submission provides APRA's perspective on several key issues relevant to the Issues Paper, as well as some brief background on the superannuation system and prudential framework.

We are happy to answer any questions you may have in relation to this submission.

Yours sincerely,

Helen Rowell  
APRA Member



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Australian Prudential Regulation Authority

# Productivity Commission Issues Paper: Superannuation efficiency and competitiveness

Submission from the Australian Prudential Regulation Authority

27 April 2016

## Executive summary

The Australian Prudential Regulation Authority (APRA) welcomes the Productivity Commission study to develop criteria to assess the efficiency and competitiveness of the superannuation system. An efficient and competitive superannuation system should lead to enhanced retirement outcomes for members. The criteria developed should therefore seek to assess the extent to which improvements in efficiency and competition contribute to enhanced net outcomes for members.

As noted in APRA's second submission to the Financial System Inquiry (FSI), for any given pattern of contributions, members' retirement outcomes are driven primarily by investment performance. However, insurance and other benefit design aspects, fees, costs, taxes and the form and timing of benefits taken by members are also relevant when considering outcomes for members. In fact, a range of different investment strategies and cost and fee structures could be expected to deliver appropriate retirement outcomes for members over the long term. A wide range of factors must therefore be taken into account when assessing efficiency (and also competitiveness), and when comparing the Australian superannuation sector with other jurisdictions.<sup>1</sup>

It is also important to note that, given the varying needs and retirement objectives of individual members, there is no single "best" outcome or approach that would be expected to deliver appropriate net retirement outcomes for all members across the superannuation system as a whole. An appropriately broad assessment therefore necessarily involves both qualitative and quantitative assessment approaches and measures, which is consistent with the broad approach proposed by the Productivity Commission for development of assessment criteria.<sup>2</sup> APRA encourages the Productivity Commission to establish criteria that recognise the importance of optimising overall long-term outcomes across a wide range of factors and taking into account the broad spectrum of funds and members across the superannuation system.

In that context, APRA notes that the lowest fee structure will not necessarily provide better outcomes for members over the long term. Enhancing overall long-term member outcomes by, for example, improved education and advice to support informed choices by members or more tax-effective investment management, may have a more material impact on long-term net outcomes for members than relatively small reductions in investment or administration fees. Optimising insurance arrangements to appropriately balance the cost of insurance with meeting member needs is also a relevant consideration in terms of overall long-term member outcomes.

APRA's second submission to the FSI also noted that, from a prudential perspective, ultimate member outcomes are enhanced by a robust and well-managed superannuation sector. This requires adequate investment in, and maintenance of, infrastructure and controls consistent with meeting APRA's requirements for sound risk management. In determining the appropriate level of costs incurred and fees to be charged to members, trustees of APRA-regulated superannuation entities (known as Registrable Superannuation Entity (RSE) licensees) must therefore strike an appropriate balance between the resources required to

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<sup>1</sup> APRA 2014, Financial System Inquiry – Response to the Interim Report, page 7.

<sup>2</sup> Productivity Commission 2016, Superannuation Efficiency and Competitiveness – Issues Paper, page 11.

maintain adequate systems, processes and controls over time with a desire to ensure that the fees charged to members do not unduly reduce ultimate member outcomes.

The superannuation sector continues to consolidate and it is likely that further consolidation may promote efficiency without unduly impacting competition in the sector as the superannuation sector remains far less concentrated than other APRA-regulated industries.<sup>3</sup> Further, whilst there have only been four new RSE licences granted in the past five years, in APRA's view the existing regulatory and prudential settings establish an appropriate minimum standard for all participants and are not a material barrier to entry for new competitors; market factors such as the need to access distribution channels and have sufficient financial resources to meet start-up costs are likely to be more relevant in this regard. Improvements could, however, be made to the regulatory framework to facilitate timely and effective exits from the industry where RSE licensees determine that to do so is in the best interests of members.

Finally, APRA notes that it is challenging to undertake meaningful comparisons of RSE licensees, funds and products offered within the superannuation system for a range of reasons. These include deficiencies in the quality and consistency of available data, as well as the complexity of structures and arrangements within the superannuation system. These constraints limit the ability to undertake comparable calculations and provide appropriate levels of transparency, including looking through various related party or other structural arrangements. These challenges are not peculiar to the Australian system and are also experienced in overseas jurisdictions. APRA therefore recommends that this is taken into account by the Productivity Commission in developing criteria to assess the efficiency and competitiveness of the superannuation system.

Further detail on the issues noted above is set out in this submission, and further background information on the superannuation industry and the prudential framework is provided in Attachment A.

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<sup>3</sup> Rowell, H. 2016 'Governance and culture in superannuation' speech to AFR Banking and Wealth Summit, Sydney, 5 April.

## Introduction

The Australian Prudential Regulation Authority (APRA) is the prudential regulator of the Australian financial services industry.<sup>4</sup> APRA was established on 1 July 1998 and is largely funded by the industries that it supervises.

APRA supervises a wide range of superannuation funds under the *Superannuation Industry (Supervision) Act 1993* (SIS Act); these are known as registrable superannuation entities (RSEs). Trustees of RSEs must be licensed by APRA under the SIS Act as a registrable superannuation entity licensee (RSE licensee).<sup>5</sup> A register of RSE licensees and RSEs is available on the APRA website.<sup>6</sup>

APRA is also the national statistical agency for information on the financial sector in Australia. APRA uses data from the institutions it supervises as a vital input into its assessment of risks in these institutions and in the financial sector more generally. APRA also collects statistical information on behalf of the Reserve Bank of Australia (RBA) and the Australian Bureau of Statistics (ABS).

APRA requires all regulated entities, under the *Financial Sector (Collection of Data) Act 2001*, to lodge a range of statistical returns, typically on a quarterly or annual basis depending on the nature of the data collection. Using this data, APRA produces regular statistical publications that include information on the financial position and other aspects of all APRA-regulated industries, including the superannuation sector.

APRA-regulated institutions currently hold \$5.7 trillion in assets for Australian depositors, policyholders and superannuation fund members. At 30 June 2015, the APRA-regulated superannuation industry held assets totalling \$1.2 trillion.<sup>7</sup>

## Outcomes for members

The Issues Paper notes that the superannuation system at the member level does not function in a manner similar to other markets in that customer decision making does not necessarily drive competition and reductions in cost and price, in part due to the level of member disengagement.

APRA's prudential framework and supervisory approach focuses on ensuring that RSE licensees comply with the overarching legislative obligation to act in the best interests of members. The assumption underlying this approach is that compliance with this obligation should lead to achievement of appropriate outcomes for those members over the long term.

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<sup>4</sup> APRA oversees banks, credit unions, building societies, general insurance and reinsurance companies, life insurance companies, private health insurers, friendly societies, and most of the superannuation industry.

<sup>5</sup> The two main types of superannuation funds that are exempt from APRA supervision are: 19 public sector superannuation funds under the responsibility of relevant Federal, State or Territory Governments are exempt from prudential supervision, unless they have opted to be supervised by APRA; and self-managed superannuation funds (SMSFs) are regulated by the Australian Taxation office.

<sup>6</sup> <http://www.apra.gov.au/RSE/Pages/default.aspx>

<sup>7</sup> Although not regulated by APRA, self-managed superannuation funds held another \$0.59 trillion in assets.

APRA's submission to the Financial System Inquiry (FSI) noted the importance of focusing on the overall outcomes for members over the long-term, and not just fees and costs, when considering how well the system is performing and whether it is effective and efficient. That requires a range of performance measures or attributes to be considered, including the net return achieved over the long term, the level of retirement income that is delivered and the other benefits and services, including insurance, that are being provided.

Since 2013, RSE licensees have been required to determine annually whether their MySuper product<sup>8</sup> has access to sufficient scale (with respect to both assets and number of members) so that members of the product are not disadvantaged in comparison to members of other MySuper products. APRA's view is that, consistent with the underlying philosophy of the SIS Act, all RSE licensees should regularly assess the extent to which appropriate net outcomes for members are being achieved over the long term based on a broader set of qualitative and quantitative factors, regardless of whether or not they offer a MySuper product.

This section highlights some areas that are relevant for RSE licensees to consider in the context of securing appropriate outcomes for members.

### ***Planning for the future***

Central to RSE licensees achieving appropriate outcomes for members is being well-equipped to respond to ongoing developments in their industry. An RSE licensee with sound business and strategic planning processes will generally be more resilient as the shape and nature of the superannuation system continues to evolve, and better able to respond to emerging competitive pressures.

APRA's view is that the strategic and business planning processes adopted by RSE licensees should be of a similar standard to the processes adopted in other financial services sectors to ensure that they are well-positioned to adapt, respond and remain relevant in an increasingly complex and rapidly changing environment. Each RSE licensee should therefore be setting their strategic direction, undertaking appropriate business planning, monitoring progress against those plans, and taking necessary actions should outcomes not be as expected. Sound business planning also requires RSE licensees to look beyond simply reducing costs to consider the investments in new or enhanced systems and processes (including accessing new technologies as appropriate) that may be needed to ensure ongoing sustainability, delivery of enhanced member outcomes and identification and management of risks.

### ***Changing demographics***

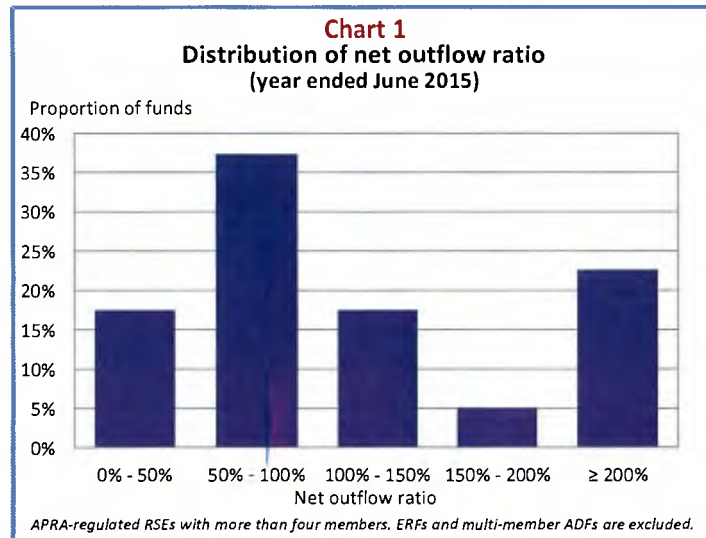
Emerging demographic trends are likely to have potentially significant implications for the future strategy and viability of many RSE licensees due to their impact on overall growth and cash flow/liquidity management. These trends are also potentially relevant to any assessment of efficiency and/or competitiveness.

At an industry level, net contribution flows remain positive, with total contributions exceeding benefit payments and net benefit transfers. However, the net outflow ratio (i.e. the ratio of cash outflows to cash inflows) for the industry is slowly trending upwards with

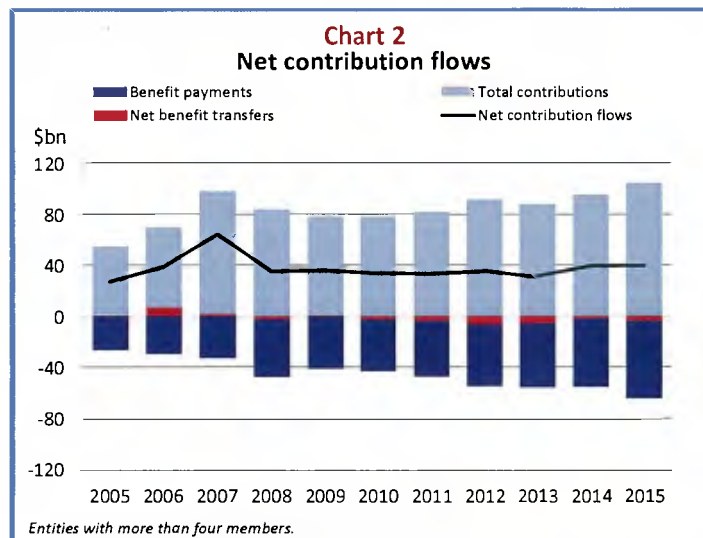
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<sup>8</sup> MySuper products were introduced as part of the Stronger Super reforms of the previous Government and replaced existing default products. They are required to have the characteristics set out in section 29TC of the SIS Act.

almost half of the industry - or 45 per cent of APRA-regulated funds - having a net outflow ratio exceeding 100 per cent for year ending June 2015 (Chart 1). More than 20 per cent of funds experienced a decline in net assets over that period.



Part of the driver for the upward trend in cash outflows is the continued increase in total member benefit payments. There is also a clear (albeit relatively slow) trend towards pension benefit payments and away from lump sum benefit payments. These trends can be expected to continue as the age profile of members in many funds also increases and hence an increasing proportion of members reach the post-retirement phase.



### **Fund size and industry consolidation**

As noted above, the superannuation sector continues to consolidate and it is likely that further consolidation may promote efficiency without unduly impacting competition in the sector as the superannuation sector remains far less concentrated than other APRA-regulated



industries. APRA's view is that there is no minimum or threshold size for a superannuation fund that guarantees that appropriate outcomes for members will be achieved over the long term. Some small funds are able to operate efficiently and effectively and have sound strategies and niche positioning that should position them well for the future. However, it is important that all RSE licensees - large and small - review their strategic direction and plans in the context of emerging industry trends to ensure that they will be able to continue to deliver appropriate outcomes for members into the future.

There are significant complexities in the superannuation system, with scope for efficiency to be enhanced through rationalisation or simplification in some areas, including in the range of products and options offered by RSEs to members. For example, recent information reported to APRA indicates there are over 40,000 investment options made available across the industry. While these options are intended to cater to perceived or actual member demand, the operational and other complexities that arise from managing such a large number of investment options is material. This is likely to lead to cumbersome and inefficient processes and significantly increased operational risks, which may ultimately adversely impact all members of an RSE.

### ***Insurance offerings***

Since 2012, RSE licensees have been under an explicit obligation to not allow retirement outcomes for members to be unreasonably eroded by the fund's insurance offering. All RSE licensees should undertake detailed analysis and have documented processes in order to demonstrate that decisions in relation to insurance are being made in members' best interests and that the erosion of benefits covenant in section 52(7) of the SIS Act is being met. This is essential as members are often 'defaulted' into insurance products (life insurance and total and permanent disability insurance) without making active decisions about whether the insurance or the level of cover is appropriate for their needs.

Insurance premiums have increased significantly in recent years, and RSE licensees need to work with the insurance industry to ensure that insurance benefit design is sustainable and affordable for members over the longer term.

### **Barriers to entry and exit**

Although there have only been four new RSE licences granted in the past five years, the existing regulatory and prudential settings establish an appropriate minimum standard for all participants and are not a material barrier to entry for new competitors.

Entities seeking to operate in all APRA-regulated industries must meet minimum regulatory requirements, including prudential standards and licensing requirements. Superannuation is essentially a managed investment with a number of particular characteristics, including compulsion, preservation rules that restrict access until retirement and taxation advantages. In addition, as noted in the Issues Paper, a material level of disengagement is present amongst many members. In light of these characteristics, it is appropriate that there is a robust set of regulatory requirements to be met in order to be able to offer superannuation products. Prudential regulation of superannuation does not seek to guarantee against fund failure, but rather seeks to minimise the likelihood of loss to fund members through failure, by requiring, for example, RSE licensees to have appropriate expertise (via fit and proper standards) and effective risk management frameworks and processes.



Some of the potential market or structural barriers to entry include whether the prospective applicant has immediate and ongoing access to a sufficient pool of members via appropriate distribution channels, and whether they have sufficient financial resources to meet start-up costs such as initial operating and investment costs. Further, due to their smaller size, new entrants may be at a cost disadvantage relative to incumbents when negotiating key service provision, such as with investment managers.

### ***Prudential regulatory requirements***

An applicant seeking to operate an APRA-regulated superannuation entity must hold an RSE licence as required under the SIS Act.<sup>9</sup> Section 29D of the SIS Act prescribes the basis upon which APRA must grant an RSE licence. This includes, amongst other matters, that APRA has no reason to believe that the applicant would fail to comply with its licence conditions. An applicant seeking an RSE licence is required to pay the appropriate fee<sup>10</sup> and once licensed, an annual levy<sup>11</sup>, but both are relatively modest in the context of total industry assets.

### ***Capital requirements***

Unlike other APRA-regulated industries, there are currently no capital requirements imposed on RSE licensees.<sup>12</sup> Since 2013, a risk-based operational risk financial requirement (ORFR) has applied to all RSE licensees, regardless of whether they are public offer or non-public offer RSE licensees.

*Prudential Standard SPS 114 Operational Risk Financial Requirement* (SPS 114) establishes requirements for an RSE licensee to maintain adequate financial resources to address operational risk events that may affect its business operations. APRA expects a soundly run RSE licensee that has implemented an effective risk management framework to have an ORFR target amount that is equivalent to at least 0.25 per cent of funds under management.

### ***Exiting the industry***

Under the SIS Act, a transfer of members' benefits in a fund must only be made with the consent of fund members or via a bulk transfer of member interests to a new or 'successor' fund.<sup>13</sup> A decision by an RSE licensee to undertake a successor fund transfer, and the particular successor fund that is chosen, must be made in the best interests of members.

There appear to be some constraints that may be affecting decisions by RSE licensees to undertake a successor fund transfer. One example is the uncertainty as to whether the

<sup>9</sup> Trustees of SMSFs and public sector superannuation schemes are not required to hold an RSE licence.

<sup>10</sup> Refer to r. 3A.06 of the Regulations.

<sup>11</sup> <http://www.apra.gov.au/Super/Levies/Pages/Super-levies.aspx>

<sup>12</sup> Prior to the Stronger Super reforms, public offer RSE licensees were required to hold \$5 million in capital under the requirements in s. 29DA of the SIS Act and r. 3A.04 of the SIS Regulations.

<sup>13</sup> A successor fund as defined in regulation 1.03 (1) of the SIS Regulations in relation to a transfer of benefits of a member from a fund (the original fund), is a fund which satisfies the following conditions: (a) the fund confers on the member equivalent rights to the rights that the member had under the original fund in respect of the benefits; and (b) before the transfer, the trustee of the fund has agreed with the trustee of the original fund that the fund will confer on the member equivalent rights to the rights that the member had under the original fund in respect of the benefits.

capital gains tax relief provided for MySuper transfers until 1 July 2016 will be extended. Another example is uncertainty as to what is required by RSE licensees to be satisfied that a successor fund transfer is appropriate for MySuper products with materially different features (such as from a life cycle to non-life cycle product). APRA is currently developing prudential guidance in this latter area.

## **Comparing superannuation offerings**

As noted earlier, there are material limitations in drawing conclusions on the level of competition and efficiency in the industry based only on frequently-used industry metrics, such as investment returns and fee and cost levels. Given the varying needs and retirement objectives of individual members, and hence the substantial differences between RSEs and the products offered within them, an appropriately broad assessment that involves both qualitative and quantitative assessment approaches and measures is required. Further, there should be an emphasis on performance against objectives, including achievement of appropriate overall retirement outcomes, rather than short-term comparisons against peers.

There are also limitations in currently available superannuation data, as outlined below, that limit the ability to undertake comparable calculations and provide appropriate levels of transparency.

### ***Limitations of APRA data collection***

A key objective of APRA's revised data collection, which has been progressively implemented since July 2013, is to facilitate like-for-like comparisons based on more granular information for MySuper products and other investment options. APRA's enhanced publications focus on the assessment of performance relative to objectives over periods such as five and ten years, noting it will take several years before APRA has sufficient data to provide this longer term view at the product and option level. APRA anticipates that its enhanced data collection will ultimately provide a greater understanding of the underlying differences between funds and key drivers of performance - raising levels of transparency and supporting more meaningful comparisons between RSEs.

Nevertheless, data about the superannuation system collected by APRA has limitations. This in part is due to deficiencies in the quality of data reported (and the underlying systems and processes of RSE licensees). APRA continues to work with industry to improve the quality of the data that is reported, and hence the consistency and reliability of APRA's publications for the superannuation industry (and the data used by APRA for supervision purposes). Prior to the most recent release of the annual publications, however, APRA raised 1400 queries on the information submitted which led to over 500 data re-submissions. This suggests that there is some way to go before APRA can be comfortable that credible and reliable information is available to meet the enhanced transparency and disclosure objective of the Stronger Super reforms.

APRA's data collection is also only as comparable as the underlying products and business processes that generate the information to be reported to APRA. There are a number of structural features of the superannuation system, including the flexibility for RSE licensees to structure their business and products as they deem appropriate (subject to legislative constraints), which mean that a number of areas of reported data are not inherently comparable.

### ***Comparison based on investment return***

The majority of RSE licensees offer, from within their RSEs, both default and choice products. The default offering, now in the form of MySuper products, requires the RSE licensee to formulate and implement an investment strategy with no (or little) input from the membership and to meet additional legislative obligations. This reflects the fact that the member has typically not made a decision to be in the particular RSE.

For choice products, on the other hand, there is scope for much greater direction from members of the RSE in relation to investments, notwithstanding that the RSE licensee must still set the investment strategy for the choice products offered to members. This greater member involvement in investment decision-making means that assets in choice products are more likely to be moved between investment options or funds at the discretion or instigation of the member. In contrast, default assets are typically more long term or passive in nature. This has implications for the investment strategy and liquidity requirements of an RSE licensee when managing their choice products, as there is generally a need to ensure that sufficient assets are available to be moved at relatively short notice to a different option (or another RSE) based on the switching decisions made by members.

This difference in potential liquidity management needs between default and choice products also needs to be borne in mind when undertaking investment performance comparisons at the whole of fund level. For example, there are retail funds where over 80 per cent of assets are invested in choice products, whereas industry/public/corporate funds tend to have a much higher proportion of assets held for default members. Whole of fund investment performance comparisons between funds with substantially different levels of default vs choice members/assets are therefore likely to be less meaningful than comparisons at product or investment option level.

Further, whilst there are some common features required of all MySuper products (for example, the prescribed fees), RSE licensees are free to set an asset allocation for their MySuper product that promotes the financial interests of the members of the particular MySuper product. This means that, whilst MySuper products may have common features at a conceptual level, they are far from being homogenous and interchangeable. This is particularly the case for lifecycle MySuper products, which effectively reflect a series of investment strategies that change over the course of an individual member's life (without their involvement). Comparison of such products at the 'lifecycle stage' level, rather than in respect of the product as a whole, is likely to be more appropriate.

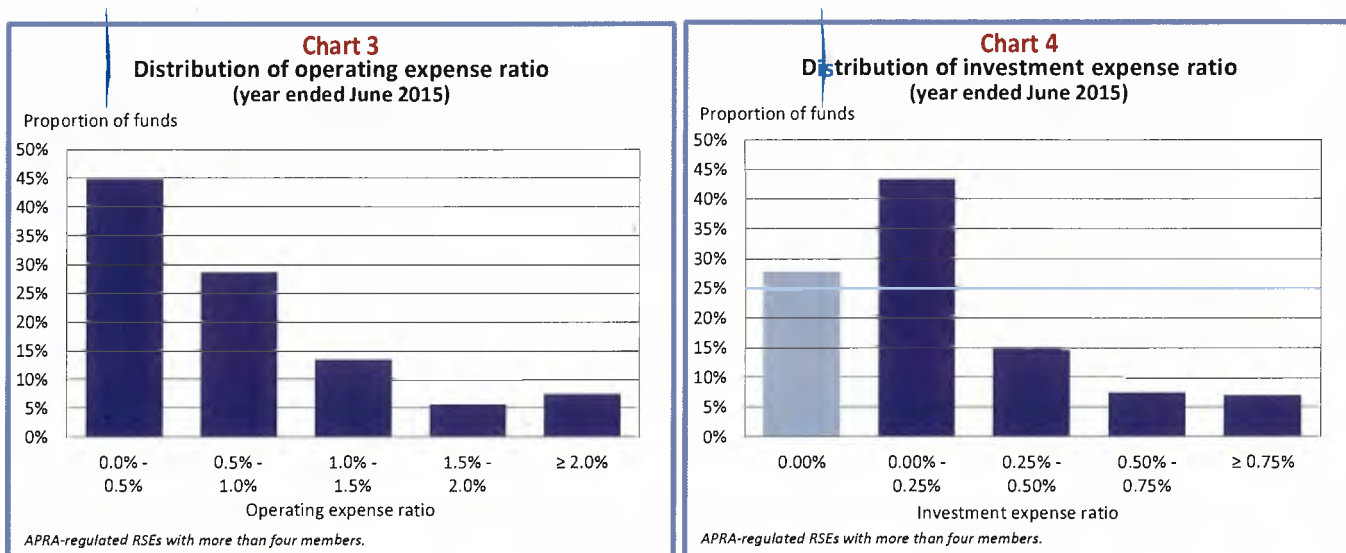
The challenges of comparability are exacerbated for choice investment options given the wide range of options that are available, from various mixed asset class options to single asset class options, or options with specific assets (such as individual shares). As a result, choice products ideally need to be categorised to allow like products to be compared with each other to reasonably compare investment performance across different choice products.

### ***Comparison based on fee levels***

The previous Government's Stronger Super reforms placed considerable emphasis on enhanced transparency and disclosure for the superannuation industry. While the industry has made significant efforts to meet heightened reporting and disclosure requirements, there remains room for improvement in the accessibility, consistency and reliability of the information that is reported to APRA and disclosed to fund members (and other stakeholders).

One area in particular that has proved problematic is the reporting and disclosure of fees and costs. In particular, there needs to be greater consistency of reporting of the underlying costs associated with running a superannuation fund to be able to meaningfully assess the relative efficiency (or otherwise) of different RSEs and the impact of fees and costs on the outcomes for members.

At present, RSE licensees are required to report fund expenses under *Reporting Standard SRS 330.0 Statement of Financial Performance*. The range of reported expenses is quite wide (particularly for reported operating expenses) and the quality of the underlying expense data reported to APRA is quite variable. For example, 28 per cent of funds reported zero investment expenses for their year of income ending June 2015. This likely reflects that investment costs are not being separately identified and reported as intended. For instance, these costs they may be included under other items or not reported where, for example, they have been netted off investment returns.



Finally, as discussed above, assessing competition and efficiency largely on the basis of the level of fees and costs does not adequately recognise the fact that higher fee levels may be associated with better net outcomes for members.

### International comparisons

As Australia’s compulsory superannuation system is relatively unique, international superannuation/pension structures and benchmarks are unlikely to be directly comparable with the Australian system. For example, it is common in overseas jurisdictions for pension funds to be run by a Government organisation, rather than by the private sector, with quite different benefit design, investment and cost arrangements.

Comparisons of fee or cost levels between RSEs and international equivalents (e.g. MySuper products compared to low cost funds) may therefore not be reliable or appropriate due to the different methodology used to calculate and/or attribute fees or costs or different regulatory approaches. For example, the United Kingdom Government has introduced ‘charge-caps’ on defined contribution pensions which seeks to limit or place a maximum on pension scheme investment and administration charges. The effect of this constraint would need to be

considered in any comparison of the relative efficiency of Australian RSEs and United Kingdom funds based on fee levels.

## An ‘outsourced’ industry

Outsourcing or the use of third party providers is a significant feature of the superannuation industry. Commonly outsourced functions include investment management, administration services and custodial services.

RSE licensees are trustees with responsibility to oversee the key business operations under the trustee. RSE licensees often have limited direct resources and hence, while they remain at all times legally responsible for their business operations, it is open to RSE licensees to outsource some activities to third parties. Such outsourcing is subject to the requirements of *Prudential Standard SPS 231 Outsourcing*, other relevant prudential standards and the RSE licensee’s duties under general law and the SIS Act and SIS Regulations.

For many RSE licensees, third party providers play a key role in supplying expertise and services that may not be available within the RSE licensees’ operations. There is, however, an increasing trend to insource more activities, particularly investment management, often with a view to increasing the control over and potentially reducing the costs associated with such activities.

These differences in the use of outsourced vs insourced arrangements need to be considered when developing criteria for the assessment of efficiency and competitiveness of the superannuation industry.

## Attachment A

The information in this Attachment provides current background on the superannuation system and a brief outline of the prudential framework for APRA-regulated superannuation entities.

At 31 March 2016, there were 136 RSE licensees responsible for managing 230 RSEs under their trusteeship. Of these RSE licensees:

- 91 RSE licensees hold a class of licence that enables the RSE licensee to offer superannuation to the general public (i.e. either a 'public offer' or 'extended public offer' licence); and
- 45 RSE licensees hold a class of licence that restricts them to offering superannuation to members linked to a standard employer sponsor (i.e. a 'non-public offer' licence).

### Ownership and governance of RSE licensees

Whilst the SIS Act requires that an RSE licensee is either a constitutional corporation or a group of individual trustees<sup>14</sup>, RSE licensees do not have to comply with any other structural requirements. Ownership of RSE licensees generally falls within one of the following four categories<sup>15</sup>:

- owned by unions or employer associations and with members traditionally drawn from a particular industry (typically industry funds);
- owned by a single employer or related group of employers with members drawn from a particular company or associated company (typically corporate funds);
- owned by a Government of Government departments/agencies with members drawn from public sector organisations (typically public sector funds); and
- owned often by financial services organisations with members drawn from the general public (typically retail funds).

Generally, owners have the power to appoint directors to the RSE licensee's board. Approximately 61 per cent of RSE licensees report themselves as having a 'not for-profit' status, with the remaining 39 per cent reporting a 'for-profit' status.

Part 9 of the SIS Act currently requires an RSE licensee that holds a non-public offer licence to have a board that is constituted of an equal number of member and employer representatives. Such boards may also appoint an independent director if the appointment is permitted under an RSE's governing rules and is requested by the employer or member

<sup>14</sup> Refer section 29D of the *Superannuation Industry (Supervision) Act 1993*.

<sup>15</sup> At 30 June 2015, approximately 38 per cent of RSE licensees were under financial service corporation ownership, 18 per cent under employer sponsor (non-public sector) ownership, 17 per cent under nominating organisation ownership, 5 per cent under public sector organisation ownership, 1 per cent under public company ownership and 21 per cent under other ownership types.



representatives on the board. The legislation also permits these RSE licensee boards to seek APRA’s approval to appoint additional independent directors.

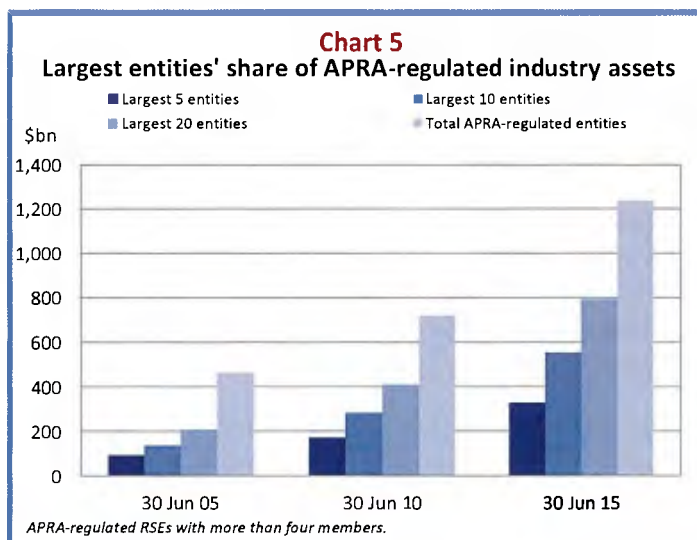
There are no legislated requirements relating to the board structure of RSE licensees with a public offer licence.

### Industry consolidation

The superannuation industry is the least concentrated of the industry sectors that APRA supervises. Nonetheless, consolidation is continuing to occur, reflecting similar trends to those that have occurred in elsewhere in the financial sector.

At 30 June 2015, the 20 largest funds represented 64 per cent of APRA-regulated industry superannuation assets<sup>16</sup> compared to only 44 per cent in 2005. A substantial tail of relatively small funds also remains; the median fund size at 30 June 2015 was approximately \$700 million, with a number of funds significantly smaller than this figure.

Whilst consolidation has taken place across all types of APRA-regulated superannuation funds, this has been most pronounced in corporate fund sector. In 2010, there were 84 corporate RSEs however at 30 June 2015 there were only 34. APRA notes that, while the rate of consolidation of RSEs has slowed, the total number of RSEs is expected to continue to reduce over the medium to long term.



### The superannuation prudential framework

The superannuation prudential framework includes the SIS Act, *Superannuation Industry (Supervision) Regulations 1994*, prudential standards, reporting standards and associated prudential guidance. The primary purpose of the prudential framework is to seek to ensure, to the extent reasonably possible, that RSE licensees are undertaking their duties and responsibilities in the best interests of members.

<sup>16</sup> At 30 June 2015, the 20 largest funds ranged in size from \$18 to \$95 billion in assets.



The superannuation prudential framework has been significantly enhanced over the past decade. On 1 July 2004, the SIS Act was amended to implement a licensing regime which required trustees of all RSEs to obtain a licence and register all RSEs under their trusteeship. Once licenced, RSE licensees were required to meet specific requirements relating to governance and risk management, fitness and propriety, adequacy of resources and outsourcing.

In 2012 and 2013, the previous Government's Stronger Super reforms provided APRA with the power to make prudential standards applying to the superannuation industry. This allowed APRA to substantially harmonise the prudential frameworks across all APRA-regulated industries, whilst recognising the unique characteristics of the superannuation system.

To date, APRA has issued prudential standards relating to, amongst other things, risk management and governance, fitness and propriety requirements, outsourcing, business continuity management, audit and conflicts of interest. These standards have been effective since 2012-2013 and set heightened expectations in these key areas, with a view to encouraging enhancements in RSE licensees' governance and risk management frameworks and the effectiveness of decision-making and management of the operations for the benefit of members.

Around the same time as the introduction of the prudential standards, the previous Government established the MySuper product regime as a new, simple and cost-effective superannuation product to replace existing default products. APRA authorises RSE licensees to offer MySuper products and as at 30 June 2015, there were 116 MySuper products comprising 14.6 million accounts and holding total assets of \$428 billion. MySuper products must meet core criteria such as that there is a single diversified or lifecycle investment strategy, all members have access to the same options and facilities, and only permitted fees can be deducted from member accounts.<sup>17</sup>

RSE licensees that offer a MySuper product are required to undertake an annual scale assessment.<sup>18</sup> The assessment requires RSE licensees to consider the number of members and/or assets in both the MySuper product and the fund and form a view as to whether the members of the MySuper product are disadvantaged relative to members of other MySuper products.

MySuper products were intended to have a simple set of product features to facilitate comparison of investment performance and costs, and to ensure members do not pay for unnecessary 'bells and whistles' they do not need or use.<sup>19</sup> Additional reporting obligations have been introduced for RSE licensees to facilitate comparisons across MySuper products, however as noted earlier in APRA's submission, this data should be used with some caution.

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<sup>17</sup> Refer section 29TC *Superannuation Industry (Supervision) Act 1993*

<sup>18</sup> Refer section 29VN *Superannuation Industry (Supervision) Act 1993*.

<sup>19</sup> Refer to Explanatory Memorandum Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2012, page 3.