



19 September 2016

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

Dear Sir/Madam

APRA submission to the Productivity Commission Draft Report ‘How to Assess the Competitiveness and Efficiency of the Superannuation System’

Thank you for the opportunity to comment on the Draft Report recently issued by the Productivity Commission, ‘How to Assess the Competitiveness and Efficiency of the Superannuation System’ (the Draft Report). APRA welcomes the Commission’s study, which focuses on promoting an efficient and competitive superannuation system to enhance retirement outcomes for members over the long term.

APRA supports the comprehensive assessment approach proposed by the Commission, which incorporates a broad range of indicators and recognises that both qualitative and quantitative assessment approaches and measures are needed. The Commission’s proposed approach appropriately reflects 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.

Objectives for the review

One of the system-level objectives for the review proposed by the Commission is to maximise net returns over the long term. APRA’s view is that it is important that net returns are considered on a risk-adjusted basis, in the context of the objectives that have been set by the RSE licensee, and against benchmarks that provide a ‘like for like’ comparison. This will require the assessment to be undertaken at a range of levels, as is proposed by the Commission, recognising the range of participants across the superannuation industry with different structures, business models and products. The distinction between default (MySuper) products (where the RSE licensee has responsibility for all aspects of investment strategy and implementation) and choice products (where individual member decisions can significantly influence ultimate outcomes) is particularly important in that regard.

The proposed objectives also include meeting members’ needs (specifically in relation to insurance) at least cost and driving efficient outcomes for members. APRA’s view is that it is important that the assessment of fees and costs in the context of delivering efficient

outcomes, is considered on the basis of providing ‘value for money’ and ensuring the quality and sustainability of the benefits or services provided into the future. The least cost option or approach may not be ‘efficient’ as it may not provide the best outcome for members over the long term. In relation to insurance in superannuation in particular, as the Committee acknowledges in the Draft Report, there are significant variations and complexities in the nature and levels of cover provided. These variations present significant challenges in data collection and comparison and hence in assessing the effectiveness and efficiency of this aspect of the superannuation system. Nevertheless, it is essential that potential improvements in the efficiency and effectiveness of insurance provided through superannuation are considered as part of the review.

Data quality and transparency

The Draft Report recognises the complexity inherent in the superannuation system, the difficulties with and gaps in available data, and that significant interpretation will have to be applied to consideration of the large numbers of quantitative and qualitative indicators proposed in the Draft Report. It may assist the Commission to identify the key or primary areas and indicators to be considered in the near term to provide a robust and meaningful assessment. That would facilitate the initial assessment process, and allow the assessment framework to evolve to include a wider range of indicators over time as additional data becomes available.

As the Commission indicates in the Draft Report, much of the data that APRA collects is likely to assist the Commission in its assessment. As noted in APRA’s submission in response to the Issues Paper¹, there remain limitations and quality issues with aspects of APRA’s data collection which we are continuing to work with industry to address. The Commission’s focus on APRA (and other) data is welcome, as it should significantly assist in improving the quality and transparency of superannuation data. APRA expects, however, that data quality and consistency will remain a challenge for the superannuation system for some time.

APRA would be happy to assist the Commission with qualitative information that is likely to be required as part of the assessment process, and supports the Commission’s suggestion to undertake surveys, case studies or reviews to supplement the Commission’s analysis of currently available APRA and industry data. The additional information gathered through such means will be important to address current data gaps and target some specific areas in the assessment framework.

APRA activities relevant to the review

APRA is undertaking work in some policy areas, and as part of its supervision activities, that is relevant to aspects covered in the Commission’s Draft Report and would be happy to provide further information on these.

The Commission notes the challenges in giving effect to a successor fund transfer (SFT), including moving insured benefits and the transfer of defined benefit interests to a predominantly defined contribution fund. The introduction of MySuper in 2013, and other recent reforms, have introduced additional complexities for RSE licensees considering or undertaking an SFT. APRA is currently developing updated prudential guidance for industry that addresses some of these complexities, and expects to release it for consultation in the

¹ APRA submission, ‘Superannuation Efficiency and Competitiveness: Productivity Commission Issues Paper’, 27 April 2016, <http://www.pc.gov.au/inquiries/current/superannuation/competitiveness-efficiency/submissions>.

coming months.

In relation to superannuation governance, APRA expects to finalise at the earliest opportunity amendments to *Prudential Standard SPS 510 Governance* (SPS 510) and *Prudential Practice Guide SPS 510 Governance* (SPG 510), as outlined in its December 2015 letter to the superannuation industry.² APRA is also progressing thematic reviews into RSE licensee governance arrangements and related party arrangements, which are due to be completed in 2017. The reviews will further enhance APRA's understanding of practices adopted by RSE licensees across these areas and the findings may highlight areas where changes to the prudential framework and/or APRA's data collection may be needed.

Further detail on some of the areas noted above, and APRA's perspective on other key issues covered in the Draft Report, are set out in the attachment.

We commend the Commission on its Draft Report, and the comprehensive approach to the assessment of the superannuation system that it is proposing. Once completed, the assessment undertaken based on the framework outlined by the Commission should provide a definitive body of analysis that will be useful across a range of policy endeavours. APRA looks forward to working closely with the Commission as the review progresses and would be happy to answer any questions you may have in relation to this submission or the superannuation system.

Yours sincerely,

Helen Rowell
Deputy Chairman

² APRA letter, 'Letter to RSE licensees - Outcomes of consultation - Governance arrangements for RSE licensees', 18 December 2015, <http://www.apra.gov.au/Super/Pages/Superannuation-reforms.aspx>

ATTACHMENT

The objectives of superannuation

The system-level objectives proposed by the Commission broadly align with the Government's proposed objective of superannuation: 'providing income in retirement to substitute or supplement the Age Pension'.³

As noted above, however, APRA's view is that it is important that net returns are considered on a risk-adjusted basis over the long term, in the context of the objectives that have been set by the RSE licensee and against benchmarks that provide a 'like for like' comparison. It is also important that the assessment of efficiency considers 'value for money' and the quality and sustainability of the benefits or services provided into the future. APRA has indicated to the superannuation industry that it is important that RSE licensees assess superannuation product outcomes for members against a range of important considerations beyond just net return and fee levels, including the benefit structure; membership profile, including age characteristics and occupational profile; overall expectations for fund size, stability and growth rate of assets under management; and the broader state of financial markets.

As APRA noted in our submission on the Issues Paper⁴, a range of possible different investment strategies, and overall cost and fee structures, may be expected to deliver appropriate member outcomes over the long term. It is not necessarily the case that the lowest fee structure will provide better outcomes for members over the long term. Similarly, focusing on ways to enhance overall long-term member outcomes, such as more tax-effective investment management or reducing insurance costs, may have a more material affect over the long term than achieving relatively small reductions in investment or administration fees for members.

When considering outcomes for members, a careful balance must also be struck between efficiency and sustainability - for both the RSE licensee's business operations and its service providers. In other words, lowest costs or fees are not always better; if costs are pushed too low, the quality and sustainability of the benefits or services provided is likely to suffer.

This has been particularly observed in insurance, where RSE licensees sought higher benefits and wider coverage for lower premiums and insurers competed aggressively for market share. This resulted in material losses for insurers and a sharp rise in insurance premiums for many fund members. Similar issues also arise in administration, where tender processes with a significant focus on reduced administration costs has reduced profitability for providers to a level that can hinder their ability to reinvest into the business to maintain and improve systems and services to ensure their quality and sustainability into the future, for the ultimate benefit of members.

Measuring performance

APRA supports the Commission's consideration of benchmarks at three-levels - the system-wide level, the segment/asset class level and the fund and product level.⁵ There are, however, substantial differences between (and within) different asset classes, funds and

³ Refer to the Superannuation (Objective) Bill 2016, <https://consult.treasury.gov.au/retirement-income-policy-division/superannuation-reform-package/>.

⁴ APRA submission, 27 April 2016.

⁵ Refer to page 113 of the Draft Report.

products, which has, in APRA's experience, made comparisons particularly challenging. As noted above, the assessment needs to recognise the range of participants across the superannuation industry with different structures, business models and products, and in particular the distinction between default (MySuper) products and choice products.

Further, as noted in APRA's submission on the Issues Paper⁶, a number of different types of fees and costs must be considered separately when assessing efficiency, most notably fees and costs for investment management, administration, insurance and advice. In relation to determining net returns by asset classes, APRA also notes that there is no single definition of asset classes that is consistently used across the superannuation industry. While APRA's reporting standards define asset classes for that purpose, different categorisations are used for other purposes.⁷

It is therefore likely that comparing funds and products to an appropriate 'frontier' as is proposed by the Commission will require a range of different 'frontiers' to be considered, so that products that share the same characteristics can be appropriately assessed on a 'like for like' basis.

APRA considers that the most difficult benchmarking exercises will be those seeking to compare 'net returns'. APRA notes that performance over the long term is a key determinant of members' retirement outcomes and that there is likely to be considerable variability in some data over the short term. In its publications, APRA strongly recommends that users of its data exercise caution in making assessments or drawing conclusions based on short-term information.

A significant number of MySuper products are relatively new and do not yet have long-term track record for assessing past performance (some MySuper products are rebadged pre-MySuper default options and hence have longer historical performance information available). APRA's recent Insight article on MySuper products shows that the range of net returns for the annual periods varies more widely than the range of returns for the longer 21-month period.⁸ The article also notes that net returns for most MySuper products are near or above the relevant actual return target over this period.

Information on fees, expenses and taxes reported to APRA has some limitations in undertaking comparisons due to data quality and consistency issues as noted above. Further, fees may vary due to differences in services offered. Entities also adopt different approaches to recognising future tax liabilities and assets.

The Draft Report cites 'APRA's Standard Risk Measure (SRM)' as one means to communicate risk, noting that it fails to convey the magnitude or path of negative returns or their timing to members.⁹ To clarify, we note that the SRM is, in fact, an industry-developed measure set out in the *Standard Risk Measure Guidance Paper for Trustees*, issued by ASFA and the FSC after consultation with APRA and ASIC. It has been used for the purposes of the MySuper product dashboard and APRA's reporting framework in the absence of any alternative industry-agreed risk measures. APRA has been encouraging the industry to undertake further work to develop other measures that may appropriately communicate different risk

⁶ APRA submission, 27 April 2016.

⁷ In developing APRA's reporting standards relating to investments, APRA undertook extensive consultation to define asset classes for the purposes of the data collection. The Australian Custodian Services Association assisted APRA to ensure that the custodians were able to map securities into the APRA-defined asset classes for reporting purposes.

⁸ <http://www.apra.gov.au/Insight/Pages/insight-issue1-2016.html>

⁹ Refer to page 112 of the Draft Report.

concepts to various stakeholders.

Insurance in superannuation

The offering of insurance inside superannuation is complex and, in light of the experience in recent years, in APRA's view requires review to ensure its ongoing sustainability and suitability. Insurance inside superannuation plays an important role for members, which should continue, but the nature and level of that insurance must strike an appropriate balance that meets members' needs at a cost that does not unduly erode accumulation for retirement. APRA therefore welcomes the heightened attention given to insurance within the Commission's proposed assessment framework.

APRA is working closely with both the superannuation and life insurance industries as they respond to the issues that have been identified in relation to insurance in superannuation, including product design and claims processes. APRA also welcomes the industry-driven initiatives being undertaken to improve public understanding about insurance, including RSE licensees' enhancing communication to members to ensure that members' expectations of insurance in superannuation are consistent with a sustainable offering.

Scale test for MySuper products

Section 29VN(b) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) currently requires each RSE licensee that is authorised to offer MySuper products to undertake an annual assessment of whether beneficiaries in the fund who hold the MySuper product are disadvantaged, in comparison to the beneficiaries of other funds who hold a MySuper product within those other funds. The factors required to be considered as part of the scale test include the number of members and assets in both the MySuper product and the fund.

RSE licensees are adopting a variety of approaches to undertaking the scale test and assessing and acting on its results. It may be too early to assess whether the scale test will achieve its intended purpose and is being applied with sufficient rigour and detailed deliberation. Industry has indicated that the metrics of the scale test are not necessarily good indicators of whether the RSE licensee is failing to promote the financial interests of its members, as scale is not the sole determinant of favourable outcomes for members. APRA has been encouraging RSE licensees to consider a broader test when assessing their MySuper products; a 'member outcomes assessment' that comprehensively assesses the extent to which the MySuper product is achieving the objective of s. 29VN(a) of the SIS Act to promote the financial interests of beneficiaries.

The Commission notes that there is little publicly available information on how the scale test is applied by RSE licensees and enforced by APRA, with APRA yet to publish guidance relating to the scale test. MySuper has only been operational for a few years, and APRA has been observing industry practices over that period, identifying the better practices that are being adopted and providing guidance to industry as needed.

APRA considers sound strategic and business planning, with appropriate monitoring against those plans using relevant benchmarks, as essential for the effective management and oversight of all organisations, including superannuation. A comprehensive 'member outcomes assessment' should form part of that process. Accordingly, APRA will be paying close supervisory attention to strategic and business planning practices in recognition of its fundamental role in ensuring that RSE licensee boards deliver on their obligation to act in the best interests of members. APRA will pull together information on key themes from this work, including any trends in terms of identified issues or areas of concern, as well as areas of better practice. As part of this, APRA will continue to review the application of the scale

test across MySuper products. APRA will also consider the need for any amendments to the prudential framework to clarify its expectations in relation to strategic and business planning and the administration of the scale test.