



6 November 2017

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

Dear Sir/Madam

APRA submission to the Productivity Commission

APRA welcomes the opportunity to provide a further submission in response to the Productivity Commission's Stage 3 issues paper, 'Superannuation: Assessing Competitiveness and Efficiency' (the Stage 3 paper). This letter provides both updates on information previously submitted to the Commission and additional commentary on matters to supplement recent discussions with the Commission.

1. Barriers to mergers

The introduction of MySuper products in 2013-2014 led to additional factors that RSE licensees must consider when deciding whether to undertake a merger. As noted in a previous submission to the Commission, APRA has released *Prudential Practice Guide SPG 227 Successor Fund Transfers and Wind-ups* (SPG 227) in final form.¹ SPG 227 provides guidance for RSE licensees undertaking transfers, and specifically responds to requests from industry for guidance on the treatment of transfers between different MySuper products, as well as assessments of equivalent rights (including in the context of tailored insurance arrangements that may be unique to a fund).

Whilst there are a range of legislative requirements to be met in relation to fund mergers, APRA does not consider that the current legislative or regulatory settings create any material barriers to fund mergers taking place. In APRA's experience, there are a range of other factors, such as differing philosophies behind an RSE licensee's approach to board composition, views of shareholders and differences in strategy and business model, that are more likely to have contributed to some proposed mergers not proceeding.

2. Limitations in expenses data collected by APRA

As APRA has noted in a range of forums and letters to industry, there are currently limitations in the data reported to APRA on both RSE licensee and fund level expenditures for prudential and publication purposes that should be addressed. These include:

- a) reliance on the application of accounting standards in APRA's reporting framework in relation to reporting expenses, which permits a degree of trustee discretion and

¹ SPG 227 can be found on the APRA website at:
<http://www.apra.gov.au/Super/PrudentialFramework/Pages/superannuation-ppgs.aspx>

judgment on materiality when categorising and reporting fund expenditure. APRA has observed a range of treatments of similar expenses between RSE licensees, which reduces comparability. AASB 1056, which took effect on 1 July 2016, requires greater granularity in the reporting of fund expenses. APRA is currently reviewing the expense information reported for 2016/17 under this new accounting treatment, and so is not yet in a position to form a view as to its quality and consistency. However, APRA expects that it is unlikely to fully achieve the desired accuracy and consistency in reporting of fund expenses as some discretion remains in relation to materiality and categorisation of RSE licensee expenditure;

- b) a lack of consistent information reported on expenses paid to associated entities, partly due to uncertainty about the definition of 'associate' in APRA's reporting standards, and also the collection of service provider expenses only in respect of arrangements between the RSE licensee and the service provider; and
- c) the incomplete collection of information at the RSE licensee level.

This limits both APRA's and external stakeholders' ability to understand, and compare, how fund assets are being used in the management of fund operations.

APRA welcomes the Government's proposal to enable APRA to collect more comprehensive data relating to non-investment expenses incurred by RSEs and RSE licensees by amending the *Financial Sector (Collection of Data) Act 2001* (FSCODA).² The proposed amendment would enable APRA to require RSE licensees to provide information on a look-through basis in relation to transactions between an RSE licensee and another entity. APRA expects that this would enable the collection of more detailed information on transactions between RSE licensees and other entities, and provide additional transparency on the ultimate purpose and destination of payments from the RSE than is currently available. The collection and publication of more comparable and detailed data in this area would provide additional accountability for trustee decision-making in relation to expenditure and also support more robust assessment of the delivery of member outcomes.

APRA will commence consultation with industry and other interested stakeholders in the near future, to explore how APRA's reporting collection could be amended to address the limitations noted above by facilitating for more consistent categorisation of RSE licensee and fund level expenditure in a manner that does not impose undue compliance costs for the industry.

The development of these reporting framework proposals will also be informed by the findings of APRA's thematic review into related party arrangements across the superannuation industry, which is close to finalisation. APRA intends to release the results of this review in the near future.

3. Governance practices in superannuation

The expectations of RSE licensees has shifted over recent years from primarily focusing on compliance with legislation to a much greater emphasis on ensuring delivery of quality outcomes to members. Further, RSE licensees are managing increasingly complex financial services operations in a continually changing operating environment. This requires

² Refer to Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017 (The Bill).

appropriate governance frameworks and processes that seek to ensure the necessary mix of skills and experience on the board in the context of a rapidly evolving financial services sector.

On 25 October 2017, I spoke at an industry event on the topic of governance practices across the superannuation industry.³ My speech provided observations on recent changes in governance practices across the superannuation sector and highlighted some areas of industry better practices, based on APRA's recent board governance thematic review. Whilst there has been some improvement in industry governance practices, there remains considerable variation in the quality of practices, and evidence of good practice is certainly not universal across all RSE licensees.

Some RSE licensees have acknowledged that the governance arrangements that were appropriate when the RSE licensee was first established may require change to support the future strategy and activities of the fund. APRA continues to encourage all RSE licensees to be clear about their future strategy, what their business operations will look like as this strategy is delivered and the nature of governance arrangements that will be needed to support these.

APRA's board governance thematic review, which is nearing completion, provides an up-to-date view of governance practices for the superannuation industry and we expect to release further detail on the results of the review in the near future. This work supersedes previous analysis published by APRA and reflects legislative and other changes in the superannuation industry since that time that have required material adjustments in industry practices in many areas.⁴ In particular, this work considers a context which reflects the Stronger Super reforms including enhanced trustee and director obligations (in s. 52 and 52A of the *Superannuation Industry (Supervision) Act 1993*), a new and explicit requirement to prevent RSE licensee's being bound by their trust deed when making decisions to engage particular service providers (s. 58A of the SIS Act), as well as new prudential standards relating to governance, conflicts of interest and risk management. This limits the relevance of analysis of the industry undertaken prior to the implementation of those reforms.

4. APRA's approach to supervising the delivery of member outcomes

APRA has recently completed an assessment of all RSEs under its supervision, based primarily on data provided to APRA by RSE licensees. The methodology for this assessment was communicated to the superannuation industry in a letter dated 31 August 2017.⁵ Much of the data used by APRA in its assessment is available through APRA's statistical publications.

The use of quantitative metrics in APRA's assessment of fund performance and sustainability serves as a starting point to identify RSEs that appear to be falling short on a range of metrics considered. The qualitative aspect of the assessment captures APRA supervisors' judgment as to the robustness of an RSE licensee's strategic and business planning practices and the quality of the RSE licensee's governance and risk management frameworks. It is a

³ 'Superannuation governance in 2017: What does good look like?', Speech by Helen Rowell, Deputy Chairman, APRA at the AIST Governance Ideas Exchange, Melbourne, 25 October 2017 available on APRA's website at: <http://www.apra.gov.au/Speeches/Pages/Superannuation-governance-in-2017.aspx>

⁴ For example, 'Superannuation fund governance: Trustee policies and practices', APRA Insight Issue 1 2008 and associated working paper.

⁵ Refer to 'Letter to all RSE licensees: Assessing member outcomes in the superannuation industry', available on APRA's website at: http://www.apra.gov.au/Super/Publications/Documents/Letter_to_RSE_Licensees_assessing_member_outcomes_in_the_superannuation_industry.pdf

combination of both quantitative and qualitative metrics that ultimately determines whether an RSE licensee will be subject to increased supervisory scrutiny.

APRA's assessment has identified some RSE licensees that appear not to be consistently delivering quality member outcomes across many of the metrics considered, as well as others that have room to improve some specific aspects of their operations. The initial group which APRA has identified for heightened scrutiny and engagement in the near term includes 28 RSEs under the trusteeship of 15 RSE licensees, with RSEs on this list coming from all RSE licensee- and fund-types. The majority of these RSEs are public offer funds and approximately half have a MySuper product.⁶ APRA will also be engaging with all RSE licensees as part of its supervision activities to understand their approach to member outcomes assessments and raise any areas where there may be room for improvement based on APRA's review.

5. Likely impact of Government proposals relating to member outcomes

The Government's current proposals relating to accountability and member outcomes address weaknesses in the current superannuation regulatory framework. Some of the proposals, such as the enhanced directions power for APRA and provision for APRA to approve changes of ownership of trustees, were identified as necessary in the aftermath of the Trio collapse in 2009. Other proposals, such as those related to MySuper authorisation and cancellation, the broadening of the MySuper scale test, and enhanced reporting on expenditure, address areas that APRA believes warrant strengthening based on our supervision activities following implementation of the Stronger Super reforms in 2012/13.

Refer to the attachment to this letter for illustrative scenarios where stronger regulatory powers, as proposed in the Bill, would be expected to support a more direct and timely supervisory response by APRA.

6. Enhancing the offering of insurance in super

As discussed in previous submissions, APRA supports insurance remaining a feature of the Australian superannuation system. A sustainable and member-focused offering of group insurance has the potential to deliver benefits through improved access to cost effective insurance and addressing underinsurance in the broader community.

APRA welcomes the release of the draft Insurance in Superannuation Code of Practice (the Code) by the Insurance in Superannuation Working Group (ISWG) as an important step by the superannuation and life insurance industries in addressing issues associated with the offering of insurance in superannuation. APRA has identified, and suggested to the ISWG, some areas where the Code could be enhanced, such as processes to address unnecessary duplicate insurance for current members and promoting fewer, more consistent, policy definitions in some areas (such as in respect of TPD cover). Nevertheless, APRA considers that the Code, if effectively implemented by industry participants, would be expected to ultimately result in improved outcomes for members.

As part of its package of superannuation reforms announced in July 2017, the Government tasked APRA with making it easier for members to opt-out of automatic insurance policies provided through superannuation. APRA proposes to make a limited amendment to *Prudential Standard SPS 250 Insurance in Superannuation* (SPS 250) to require an RSE licensee to provide simple and straightforward opt-out processes for all insurance products. The draft

⁶ APRA is limited in disclosing protected information or producing a protected document about a RSE licensee. APRA considers that naming RSE licensees that are subject to the initial round of scrutiny would involve protected information.

Code requires RSE licensees to make the process of opting out of automatic cover straightforward and transparent. APRA therefore intends to wait until the final Code is settled before assessing whether any changes to *Prudential Practice Guide SPG 250 Insurance in Superannuation* (SPG 250) will be required to support the proposed changes to SPS 250.

APRA is aware that a number of RSE licensees, ahead of the Code being finalised, have reviewed their insurance offerings to ensure they remain appropriate for their members. This has seen these RSE licensees working with their insurers to better understand the insurance needs of their membership and tailor their insurance products, including coverage types and levels and thus premiums, to reflect the differing needs of various member cohorts (for example, younger members). APRA encourages all RSE licensees to undertake such reviews on a regular basis, with a view to ensuring that an appropriate balance is struck between meeting their membership's insurance needs and preferences whilst also ensuring that the cost of insurance cover does not unduly erode members' retirement outcomes. In this context, APRA notes that the Code proposes caps on average premiums which are intended to support this outcome. In designing and reviewing their insurance offering, and in particular automatic cover levels, RSE licensees would be expected to focus on their members' insurance needs, rather than seeking to provide the maximum possible amount of cover within the capped premium level.

RSE licensees' insurance offerings, including the impact of premiums on member balances, are a key component of the overall delivery of outcomes to members. Central to understanding the impact of insurance on member outcomes is having comprehensive and accurate data that, amongst other issues, enables appropriate comparisons across the industry. APRA primarily collects data relating to insurance within superannuation through *Reporting Standard SRS 250.0 Acquired Insurance* (SRS 250.0) and has observed data quality issues with reporting under SRS 250.0, including inconsistency with the data reported under other forms in relation to insurance. For example, in some cases premiums and insurance administration fees are bundled together rather than reported separately, and there is variation in the reporting of premium adjustment arrangements in financial statements by RSE licensees.

APRA is working with RSE licensees to address these reporting issues to enhance the comparability and consistency of insurance-related data. Although improvements have been made by some RSE licensees, there remains room for further improvement.

APRA looks forward to continuing to assist with Commission with its review. Please contact me or Carolyn Morris should you have any questions in relation to this submission.

Yours sincerely

Helen Rowell
Deputy Chairman

Attachment: Illustrative application of the proposed powers in the Bill

Scenario A - Directions powers

- APRA has a number of concerns regarding the fitness and propriety of the owners of the fund's administrator, as well as the payment of fees, conflicts, transparency and reliability of information provided by Trustee A.
- APRA undertakes an investigation and seeks to disqualify two directors due to conflicts of interest.
- **Potential impact of proposed powers:** Using the proposed powers, APRA could have directed the RSE licensee to remedy the conflicts management issues without having to take the more serious step of disqualifying the directors.

Scenario B - Transfer of ownership

- Company A acquires shares in an RSE licensee such that it is a majority shareholder, and thereby acquires effective control and ownership an RSE licence without having applied for a licence through the SIS Act application process.
- A key director of Company A undertakes a highly complex fraud through a managed investment scheme, and the RSE licensee ends up losing a substantial amount of fund assets.
- **Potential impact of proposed powers:** Under the proposals, Company A would have to apply to APRA to acquire a stake in the RSE licensee, providing APRA an opportunity to investigate the potential shareholder and reject the change of ownership if determined appropriate.

Scenario C – MySuper product outcomes assessment

- Fund A's MySuper product is a large superannuation fund measured by assets under management, satisfying the current scale test in section 29VN of the SIS Act.
- APRA has concerns that the product is consistently underperforming across a range of indicators.
- **Potential impact of proposed powers:** The proposed outcomes assessment will require the RSE licensee to undertake a broader assessment of outcomes, rather than merely a scale assessment. This ensures that large funds that are operating inefficiently cannot, without any further consideration, satisfy themselves that they meet the requirements of the scale test.