



## **MYSUPER APPLICATION PROCESS**

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### **Introduction**

Thank you for the opportunity to speak here today. I want to focus on three things: the outcomes of the consultation process on draft prudential standards; the MySuper authorisation process and the consultation process surrounding the new reporting standards.

But first I want to mention that a significant milestone for APRA and the superannuation industry was reached last week when the Tranche 2 Bill, giving APRA the power to make prudential standards for superannuation, passed through the Senate without amendment. Standards-making powers for super will greatly improve APRA's ability to supervise the industry and brings super into line with the banking and insurance industries.

### **Consultation on draft prudential standards**

The consultation on 11 draft prudential standards ended late July. We received 35 submissions. The feedback was generally positive. I am pleased that the industry is embracing the enhanced supervisory structure for the industry. It was a good process from APRA's point of view and there was good engagement with the industry. There was also a reasonable industry consensus on what was good and what was not. A consistent view from industry helps the process.

Most of the submissions sought only minor policy changes or requested that APRA provide further clarification. I would like to talk briefly about the main issues raised. The standards which attracted the most discussion were SPS 250 Insurance, SPS 160 Defined Benefits matters and SPS 114 Operational Risk Financial Requirement. The drafts on governance, investment governance and outsourcing also received substantive comment.

The most significant general issue was the transition to the new requirements. A number of submissions requested greater clarity about APRA's expectations with regard to the degree of compliance required with the new prudential standards. The starting date is of course 1 July 2013 and some submissions have requested that APRA give one to three years to reach full compliance.

In line with APRA's approach when new or amended standards are introduced in other industries, we would take a reasonable approach to assessing compliance in the first few months. There is a significant amount of change impacting on the industry from Stronger Super. However, the draft standards will have been out for over a year by the time they are introduced on 1 July 2013 and in many instances, licensees will have no difficulty in meeting the new requirements. Transitional provisions exist in some standards and in addition, each standard contains a provision where APRA can adjust or exclude a specific prudential requirement of the standard in relation to a particular licensee. So rather than have some formal deferral written into the standards, we will maintain the timetable but with an ability to provide flexibility where needed. Our supervisors will be talking to trustees over the coming months to assist in the transition process.

There are a couple of specific issues I would like to address. In the April Response to Submissions, APRA had proposed to restrict insurance benefits offered to members to those acquired from life insurers. A number of submissions argued that this proposal

was unnecessarily restrictive and could result in higher insurance costs for some superannuation members.

Having considered this feedback and our objectives in originally proposing this restriction, we will change the standard. RSE licensees will not be restricted to only seek income protection insurance from life insurers. The standard will be adjusted to reflect this position.

APRA's objective in developing the standard is to ensure that trustees understand the risks associated with different insurance providers and to support the proposed legislative restrictions on self-insurance announced by the Government. Our initial approach was probably prescriptive than but I believe it is possible to achieve the appropriate outcome by amending our approach.

The standard will require that RSE licensees should look at all aspects of insurance arrangements when selecting an insurer, and not just the level of insurance premiums. This requirement will be supported by guidance. It is important to ensure that the terms and conditions of all insurance products including elements such as claims philosophy align with the best interests of beneficiaries. APRA will issue guidance on insurance strategy which will include an expectation that a licensee has considered and planned for the risk that the terms and conditions of cover provided by a general insurer might not continue.

A second insurance issue relates to data quality. APRA's draft Prudential Standard SPS 220 identifies risks associated with the offering of insured benefits, or the acquiring of insurance in respect of those benefits. A major risk is poor data quality. This is a risk for both the insurer and the super fund. APRA supervises both industries and is not taking sides between funds and insurance companies. However APRA will look after the interests of fund members who are entitled to payment of claims and both industries need to raise their standards.

For the insurer, it is essential that it does appropriate due diligence on data quality provided by a super fund. Mispricing group life insurance can be very costly for an insurer, particularly as funds have become much larger. Mispricing of risk by an insurer when tendering for the business of a large super fund is a significant issue.

There are also risks to the funds. It may be that premiums are raised to cover the risks associated with potentially poor quality claims data. Alternatively, funds may find that members do not receive the benefits the fund expected them to receive.

High quality data will likely lead to better underwriting, more appropriate pricing and better insurance for members. Over time, the SuperStream initiatives should improve the quality of data available to trustees and their insurers which should lead to more efficient pricing of group life insurance.

Another area of concern raised in submissions has been with regard to the operational risk financial requirement (ORFR). Submissions called for guidance regarding the methodology for the calculation of the ORFR, noting that most funds will have little in the way of internal data. We agree that as this is a new requirement, funds will generally be unable to develop a sophisticated model to determine their own individual ORFR from the starting date.

Rather than focus on methodology, I think it is usefully to re-emphasise the underlying objective behind the ORFR requirement. In introducing the topic in our September

Discussion Paper, we noted that the ORFR is being put in place to ensure that RSE licensees put aside resources to absorb losses that are incurred as a result of an operational risk being realised. These financial resources would then enable the RSE licensee to continue to operate in the appropriate manner while the problems are being resolved.

The critical starting point therefore is a robust and well developed risk management framework. The risks covered by the ORFR must be based on the material operational risks in the risk management framework, with a whole-of-business assessment of the financial resources required to address the material operational risks of each super fund within the RSE's business operations. The amount determined would be based on the residual risks identified after taking into account any mitigants.

APRA identified as a starting point, 0.25 per cent of funds under management. However, this is not a requirement and we recognise that funds under management may not always be the most appropriate basis for calculating the ORFR.

While trustees are not constrained in how they calculate the ORFR, the basis for the outcome lies with the quality of the risk management framework itself.

If trustees have difficulty in refining their ORFR calculation, then 25 basis points may be a good start. I would imagine that as most trustees don't have the data to undertake a sophisticated model with rigorous analysis, many will use 25 basis points as a start. I would be surprised if trustees were able to develop highly calibrated models in the short term that led them to a lower amount.

### **Scale**

I might also comment on the scale test, in the light of some of the commentary last week. There seems to be a misunderstanding by some of the way in which the scale test will be applied.

APRA would be concerned if a small fund had long term poor performance and that poor performance was caused by high costs and those costs were a function of small scale. APRA would have no concerns with a small fund that was performing well. Our concern is what is in the best interests of beneficiaries. A well performing small fund need not fear that APRA would wish to use any scale related powers.

Further, APRA's concern will be with long term performance. We would not take any action against a small fund solely because it had underperformance in the short term.

### **Individual director / trustee liability**

The Stronger Super reforms include new duties applying to RSE licensees and their directors. These include a duty to promote the financial interest of beneficiaries of the fund who hold a MySuper product, in particular returns to those beneficiaries.

Some submissions have suggested that this duty should place more emphasis on longer term returns having regard to the retirement income purpose of superannuation. As this is a legislative requirement, this is not something that APRA can directly respond to. However I do note that under MySuper, beneficiaries do not make any decisions and the trustee has complete responsibility for formulating and implementing a strategy that promotes returns, as I just mentioned, so it is clear that the intent is to get RSE licensees to focus on this new duty.

A second change is to impose a range of duties on individual directors of RSE licensees. Under the new s52A, directors will have personal duties to act honestly, to exercise the care, skill and diligence of a 'prudent superannuation director' and to perform their duties and powers in the best interest of beneficiaries.

This represents a change from the current situation where directors are only obliged to take steps to ensure that the RSE licensee does these things. Under the new law the directors will have to meet these standards personally and individually.

Concerns about these new duties have been expressed in submissions, particularly on whether the defence available to RSE licensees and directors in relation to investment losses offers them too little protection, and also about the possible risk of vexatious actions by fund beneficiaries.

Given that this is also a legislative issue rather than one arising from APRA's prudential standards, it's not really an issue that APRA can directly respond to, but again, I would point out we are aware of industry concerns.

### **MySuper Authorisation**

I thought it might be useful to give some limited feedback on the early experience of APRA supervisors who have been talking to licensees about their MySuper authorisation.

A number of trustees appear to be actively engaging with the reform process. The MySuper authorisation applications are providing trustees with an opportunity to look closely at newly mandated areas such as fees, costs and scale and how such factors relate to the fund's business plan. Issues such as insurance for members and operational risk are being considered in the context of responses to APRA's discussion papers and draft standards that I referred to earlier. Many trustees are looking at their governance frameworks in recognition of the additional focus by APRA through its proposed prudential standards.

There are also a few concerns at this early stage. Some licensees do not seem yet to have actively engaged in considering what may be required for authorisation or provided the level of resources necessary to drive the substantial change process. A few trustees have given an indication that they will plan to offer a MySuper product but have not yet considered the important element of developing a risk appetite for offering such a product. Also there is probably too much focus on the methodology for calculating an operational risk financial requirement and too little focus on the purpose.

Let me offer some advice at this point. In the first instance, recognise that substantial reform is coming your way. At the very least, establish a Board or Executive Level Steering Committee to coordinate and drive your response. Begin with the most basic question: 'Can my fund offer a MySuper product which is competitive, comparable, and sustainable and in the members' best financial interest:

- understand the membership of the fund so that an appropriate investment strategy can be developed for the MySuper product;
- focus on the prudential standards in your MySuper application as you will need to demonstrate early compliance in some areas like investment governance, conflicts of interest, insurance; and

- give thought to the development of a risk appetite statement. We recognise that this is new and will develop over time but you need the basic requirements to be in place. Trustees should have a good understanding of risk and risk tolerance.

It is still difficult to estimate the number of MySuper licence applications we are likely to authorise, particularly with regard to the 'large employer' products. The authorisation ensures that each MySuper product offered by trustees is fit for purpose in providing the enhanced protections built into the legislation for MySuper members. Such protections need to be provided via authorisation for both the generic and the 'large employer' products.

## Reporting Standards

The third area of regulatory change I want to talk about today is the new reporting standards for Stronger Super. The objective of APRA's superannuation data collections and publications is to support APRA's prudential supervision and provide appropriate transparency and disclosure in relation to the operations of the super industry. Achievement of these objectives benefits all relevant industry stakeholders.

Legislative amendment (via Tranche 3) proposes a new section that will require APRA to publish quarterly information on the performance of MySuper products. Funds will need to report to APRA information to support this publication, specifically disclosed fees, investment returns and product dashboard information.

The enhanced statistical collection has been a long time coming. APRA's reporting requirements for superannuation have not been revised since 2004, and since then the industry has evolved significantly. You may recall that in May 2009, APRA released a discussion paper that proposed substantial enhancements to our data collection. This process was put on hold after the commencement of the Review into the Efficiency, Governance, Structure and Operation of Australia's Superannuation System and the government's subsequent responses to the recommendations of the review.

In the next few weeks APRA will release a discussion paper on new reporting standards for superannuation. It will incorporate reporting requirements for the Stronger Super reforms and build on the proposals from the 2009 discussion paper, including:

- collecting data at three levels: for the trustee, each fund, and within each fund;
- expanded information about investments including look-through of investment asset allocation and costs;
- information on MySuper and selected choice option investment returns; and
- expanded information relating to defined benefit funds and sub-funds.

The Tranche 3 Legislation will propose increased transparency on investments and costs. For example, licensees may be required to report information about assets that the licensee has indirectly invested in via related parties or persons connected with the licensee. The objective again is to get greater transparency in investments via enhanced look through processes.

The Tranche 3 Bill will require trustees to publish a product dashboard for each investment option. Product dashboard provisions also require an investment return target for MySuper products.

Legislation defines the fee types allowed in MySuper products and consequently an RSE licensee must report to APRA the fees relating to a MySuper product. APRA intends to

collect administration fees, buy-sell spreads, switching fees, exit fees, activity fees, advice fees, and insurance fees as described in the relevant legislation.

APRA proposes to collect a range of non prudential statistics on behalf of ASIC, the ABS and other relevant users of superannuation statistics.

In summary the new collection will facilitate enhanced fund comparability, an objective of legislation. It will have greater granularity via collecting at investment option level, an objective of industry. And it will have increased investment transparency, an objective of government and of APRA.

There is no doubt that the new collection which we anticipate will begin in 2013-14 will be significantly larger than the current collection. Industry has made requests for changes to the collection for a number of years. However we are mindful of the implementation issues and costs involved with a new collection. Consequently we welcome comment and submission from industry, particularly with regard to the relevance and cost of the proposed collection.

I hope that trustees and funds will maintain an open and constructive dialogue with APRA during this time of change. When we put out consultation papers, we welcome your views. From my comments earlier, I hope you recognise that we do take notice and we are prepared to make changes where appropriate.

Finally I want to comment on the role of ASFA during this process. As a leading industry association, ASFA has an important role, to use your own words as 'the voice of super'. APRA appreciates the constructive approach being taken by ASFA to the reform process. ASFA's Super Reform Prudential Standards Compliance Package is a good example of the positive work being undertaken. Of course, we will not always agree but we are very happy to have open discussion on areas of concern identified by ASFA. The period in which an operational risk financial requirement can be raised; audit issues; and the insurance exclusions which I commented on earlier being good examples. I am aware that ASFA also has concerns on individual trustee liability as currently formulated and concerns regarding particular elements of MySuper.

I look forward to the next 12 months as we make progress to an improved super system. Thank you for your time today.