



APRA

insight

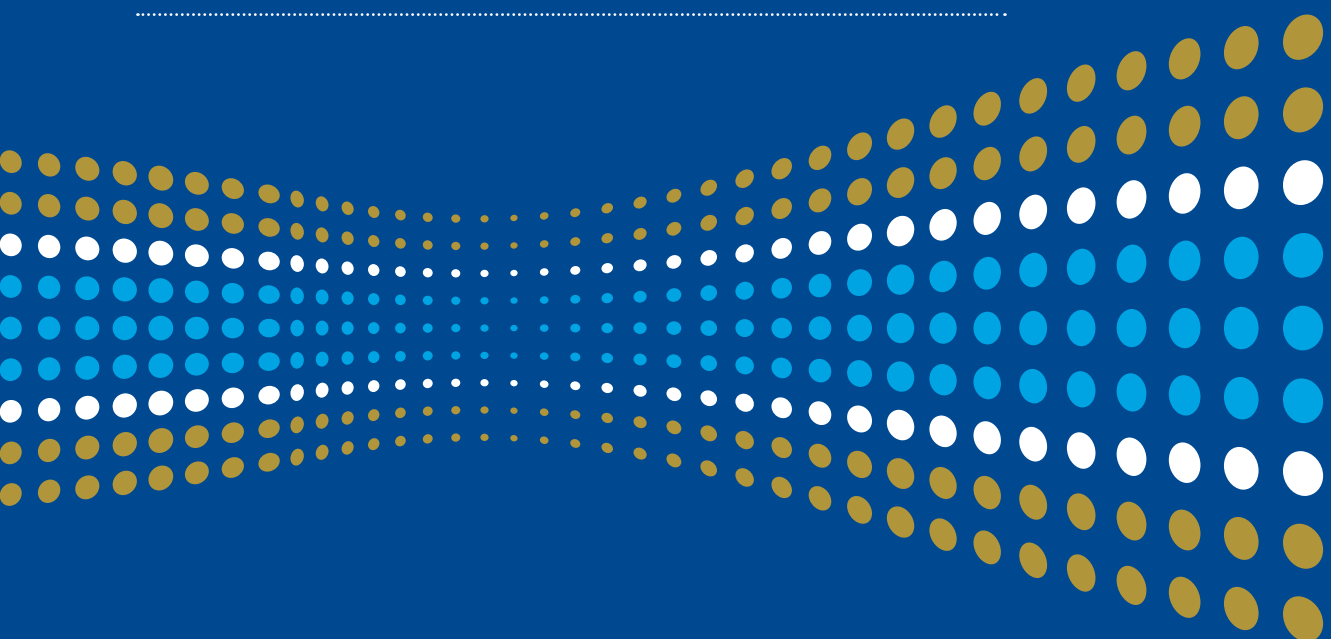
ISSUE ONE | 2012

Superannuation industry overview

APRA's implementation of the Stronger Super reforms

Insight into superannuation research

APRA's data collections



INTRODUCTION



Welcome to the first edition of APRA's revised *Insight* publication.

Insight was first published in 2001. Over the years, it has provided information on APRA's main policy initiatives and on key developments in the financial industries that APRA supervises, through both editorial articles and a raft of important statistics.

Few significant changes have been made to the publication since its inception. However, with ongoing enhancements to APRA's data collections, the original statistics in *Insight* have been, or are being, incorporated into APRA's suite of statistical publications.

As a result, the revised *Insight* is an editorial-only publication. This comes at a time when there are many new policy initiatives on APRA's plate and much to discuss with industry. At the top of the list are the Basel III capital and liquidity reforms, the review of capital for general and life insurers and the Government's Stronger Super reforms.

Insight will now be published three times a year in a smaller reader-friendly format. Each edition will include an overview of one of the three industries APRA supervises – banking, insurance and superannuation – along with articles on issues of current relevance.

In this first edition, there is an overview of the superannuation industry, which is on the cusp of significant change with the introduction of Stronger Super. There are also articles on how APRA intends to implement the Stronger Super reforms as well as discussion of APRA's superannuation research and of its statistical data collections.

I hope you enjoy reading APRA's new *Insight*.



John F. Laker

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(APRA)

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Introduction

The superannuation industry supervised by APRA has continued to consolidate. The number of registrable superannuation entity (RSE) licensees and registrable superannuation entities has continued to fall; there has been an increase in fund mergers and acquisitions within the corporate, industry and public sector fund sectors; and integrations within wealth management divisions of financial service conglomerates have taken place. The self managed superannuation fund (SMSF) sector, which is not supervised by APRA, has continued to grow in terms of funds and asset share.

Despite ongoing economic uncertainty, the year to end-June 2011 saw a further recovery in superannuation balances after the large falls at the depth of the global financial crisis. This was due to the improvement in global investment markets along with continued strong positive inflows. However, superannuation balances fell in subsequent months as global market sentiment deteriorated, although a more positive market tone began to return from January 2012.

SUPERANNUATION INDUSTRY OVERVIEW

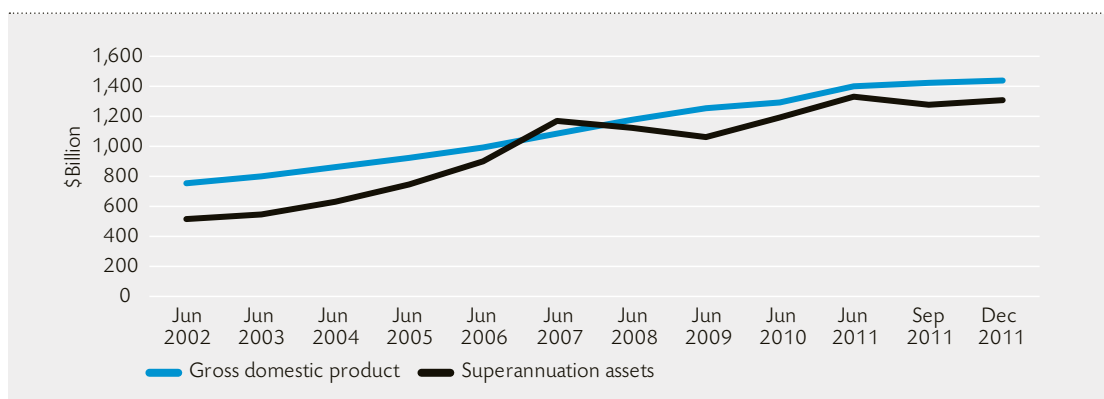
In this environment, APRA continues to have specific concerns about liquidity management resulting from frozen investments in a number of managed investment schemes, and about the management of funding positions of defined benefit funds. More generally, the management of data by trustees remains a focus of APRA's supervision. The Stronger Super reforms, described elsewhere in this edition of *Insight*, will require a higher level of governance of superannuation fund data.

Overview of the industry

Superannuation assets

The value of superannuation assets increased by 11.5 per cent from \$1.198 trillion at end-June 2010 to \$1.335 trillion at end-June 2011 (Figure 1). The increase was attributable to the continued recovery (albeit with considerable volatility) in global investment markets from crisis lows as well as strong inflows into superannuation funds. However, subsequent bouts of severe turbulence in global investment markets, as sovereign debt problems in the euro area intensified, saw a net decline in total superannuation assets to \$1.306 trillion at end-December 2011.

Figure 1: Total growth of superannuation assets and nominal GDP



Source: APRA Annual Superannuation Bulletin – June 2011 and APRA Superannuation Quarterly Performance – September 2011

Over 2010/11, total superannuation assets rose from the equivalent of 92.6 per cent of nominal GDP to 95.3 per cent. Despite the increase, this figure remains below the June 2007 high when total superannuation assets represented 108.2 per cent of GDP.

Industry population

The number of 'large funds' (funds with more than four members) reporting to APRA fell over 2010/11 from 426 to 386 (Table 1). The continuing long-term decline in the corporate fund sector accounted for 25 of the overall reduction of 40 funds. Ongoing fund mergers, acquisitions and internal integrations throughout the industry are expected to see the trend of industry consolidation continue.

At 30 June 2011, the 20 largest funds by asset size comprised nine retail funds, six industry funds and five public sector funds. The assets of these funds accounted for 59 per cent of the assets of all large funds.

The total number of member accounts also declined over 2010/11 (Figure 2). Member account numbers in corporate, industry and public sector funds remained relatively stable but there was a noticeable decline in the retail fund sector, with member account numbers for Eligible Rollover Funds' (ERFs) falling by around 23 per cent. This fall was a result of the ongoing member consolidation and the transfer of lost members to the Australian Taxation Office (ATO). These trends are expected to continue.

Distribution of assets by fund type

The share of assets held by the different types of funds is set out in Table 2. Of the \$1.335 trillion in superannuation assets at 30 June 2011, \$889 billion was attributable to large funds. The amount of superannuation assets subject to APRA's prudential regulation at that date was \$811 billion.

Retail funds accounted for 41.6 per cent of the assets of large funds while the not-for-profit sector (corporate, industry and public sector funds) between them accounted for the remainder (58.4 per cent).

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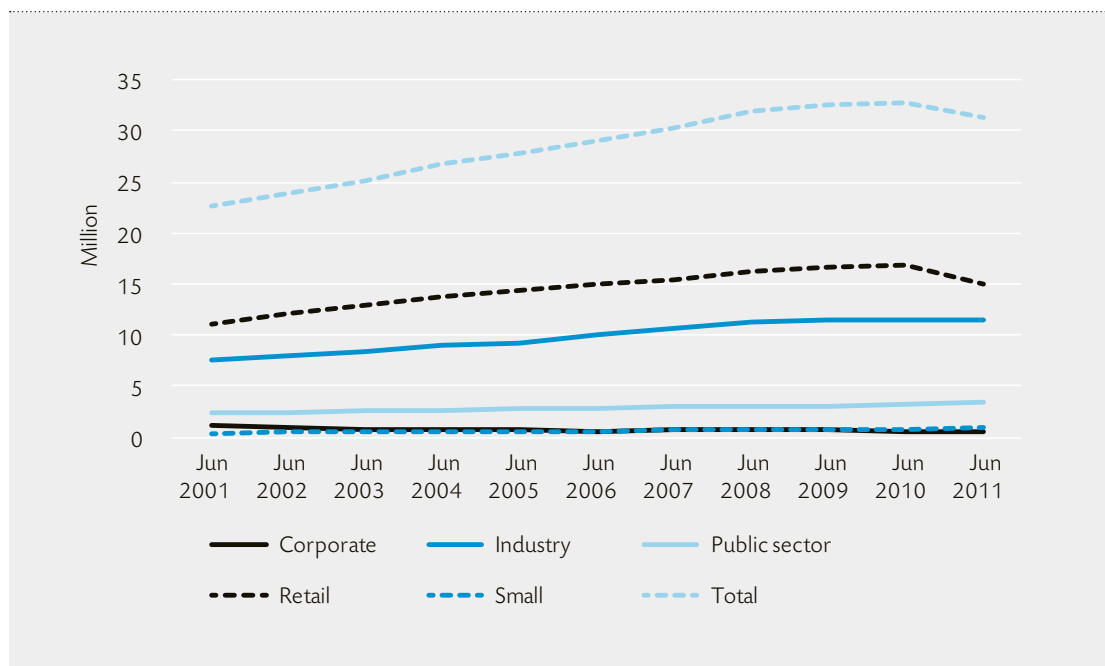
Table 1: Industry population

Fund Type	Funds			Member accounts (thousands)		
	2009	2010	2011	2009	2010	2011
Corporate funds	190	168	143	662	623	593
Industry funds	67	65	61	11,551	11,516	11,449
Public sector funds	40	39	39	3,095	3,131	3,373
Retail funds	166	154	143	16,574	16,797	15,063
Small funds*	4,389	3,972	3,610	6	5	5
ATO-regulated self managed superannuation funds	397,828	412,874	442,528	756	785	841
Pooled superannuation trusts	82	79	77	n/a	n/a	n/a
Total	402,762	417,351	446,601	32,645	32,858	31,324

Source: APRA *Annual Superannuation Bulletin* – June 2011

* Small funds include small APRA funds and single-member approved deposit funds

Figure 2: Total member accounts 2001 to 2011



Source: APRA Annual Superannuation Bulletin – June 2011

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Table 2: Total industry assets by fund type

	June 2001			June 2011		
	No. of funds	Assets \$b	% share	No. of funds	Assets \$b	% share
Corporate funds	3,224	68.4	13.2	143	58.4	4.4
Industry funds	150	60.7	11.7	61	250.7	18.8
Public sector funds	81	102.3	19.7	39	210.6	15.8
Retail funds	275	157.5	30.4	143	369.7	27.7
Small funds*	8,397	2.2	0.4	3,610	2.0	0.1
ATO-regulated self managed superannuation funds	210,667	78	15.0	442,528	407.6	30.5
Pooled superannuation trusts	177	32.3	n/a	77	86.8	n/a
Balance of life office statutory funds	n/a	49.9	9.6	n/a	36.1	2.7
Total[^]	222,971	519	100	446,601	1,335.2	100

Source: APRA *Annual Superannuation Bulletin* – June 2011

* Small funds include small APRA funds and single-member approved deposit funds

[^] Pooled superannuation trusts are not included in total assets as their assets are captured in other superannuation entity categories.

Among the APRA-regulated sector, only industry funds increased their market share, predominantly at the expense of corporate funds and, to a lesser extent, retail and public sector funds.

Table 2 also highlights how the industry has evolved over the previous decade in terms of its funds, assets and market shares. Self managed superannuation funds doubled their market share. Among the APRA-regulated sector, only industry funds increased their market share, predominantly at the expense of corporate funds and, to a lesser extent, retail and public sector funds.

The substantial increase in the number of funds over the decade was due to the rapid increase in self managed superannuation funds. All APRA-regulated fund types decreased significantly in number over this period.

Table 3 shows the distribution of assets within each APRA-regulated fund type.

Contributions

Contributions increased by 4.8 per cent over the year to end-June 2011. Figure 4 shows that this was the first increase in total contributions received since end-June 2007 (the year before the current rules regarding limits on concessional taxed contributions commenced). This is perhaps indicative of an improvement in investor confidence and Australia's continued strong employment position.

Member contributions exhibited the largest overall increase of 6.6 per cent. Employer contributions increased by 4.8 per cent, in line with the overall trend, but there was a marked decline in other contributions (which include spouse and government co-contributions) of 35.6 per cent.

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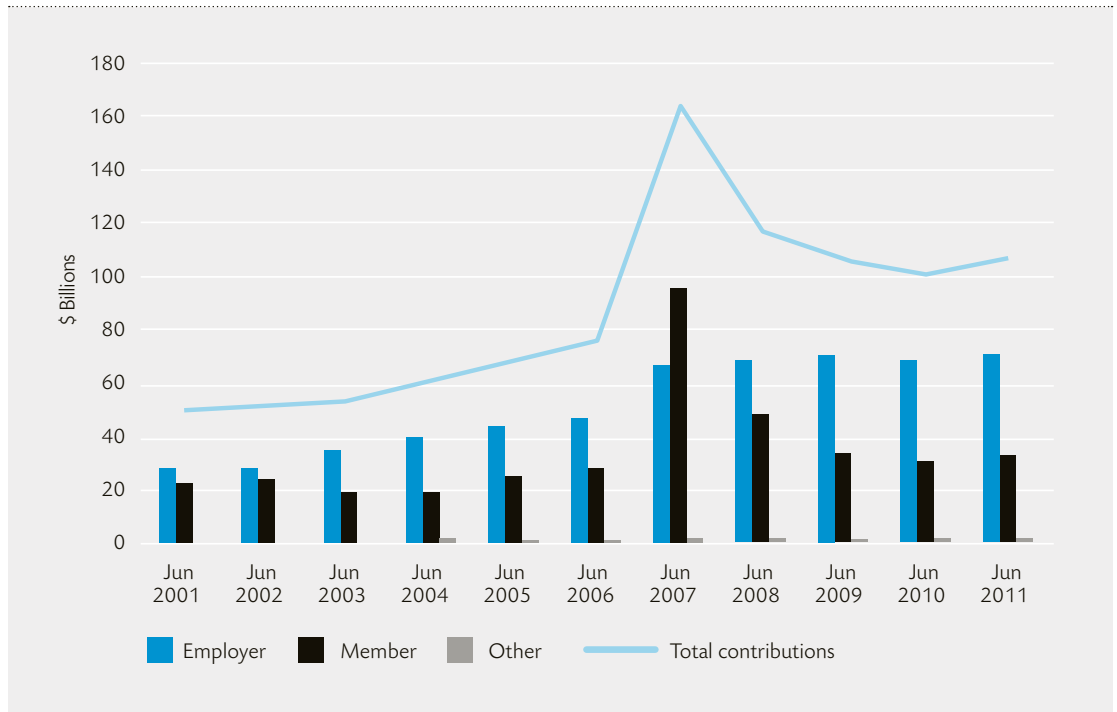
Table 3: Superannuation investments (per cent) at June 2011 – large funds

Asset type	Corporate	Industry	Public sector	Retail	Total
Cash and deposits	5.0%	7.1%	3.4%	5.3%	5.3%
Placements and loans	11.8%	7.9%	14.9%	1.2%	7.1%
Equities	28.5%	38.0%	32.5%	3.5%	21.8%
Property holdings	0.9%	0.8%	1.2%	0.0%	0.6%
Pooled super trusts	7.5%	5.4%	23.7%	8.5%	11.1%
Wholesale trusts	33.0%	33.4%	17.6%	26.4%	26.7%
Life office funds	9.8%	1.3%	0.4%	40.8%	18.1%
Unlisted public offer trusts	0.4%	3.2%	0.6%	12.7%	6.4%
Other investment	0.8%	1.4%	4.4%	0.1%	1.6%
Other assets*	2.3%	1.5%	1.1%	1.4%	1.4%
Total percentage	100%	100%	100%	100%	100%
Assets (\$ billion)	58.4	250.7	210.6	369.7	889.5

Source: APRA Annual Superannuation Bulletin – June 2011

* Other assets include receivables and deferred tax assets.

Figure 3: Total contributions to superannuation – 2001 to 2011



Source: APRA Annual Superannuation Bulletin – June 2011

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Table 4 gives a longer run of data on contributions to superannuation by contribution type. In dollar terms, contributions by employers have displayed a broadly steady increase (a decline in the year to end-June 2010 notwithstanding). Contributions by members have been more volatile, with the spike in the year to end-June 2007 related to taxation issues as members took advantage of transitional contribution rules allowing them to contribute up

to \$1 million on an aftertax basis. The subsequent sharp decline also appears related to uncertainty arising from the global financial crisis. The year to end-June 2011 saw a slight recovery in member contributions. The decline in other contributions is perhaps attributable to the reduction in the government co-contribution rate applicable for contributions made from 2009/10 onwards.

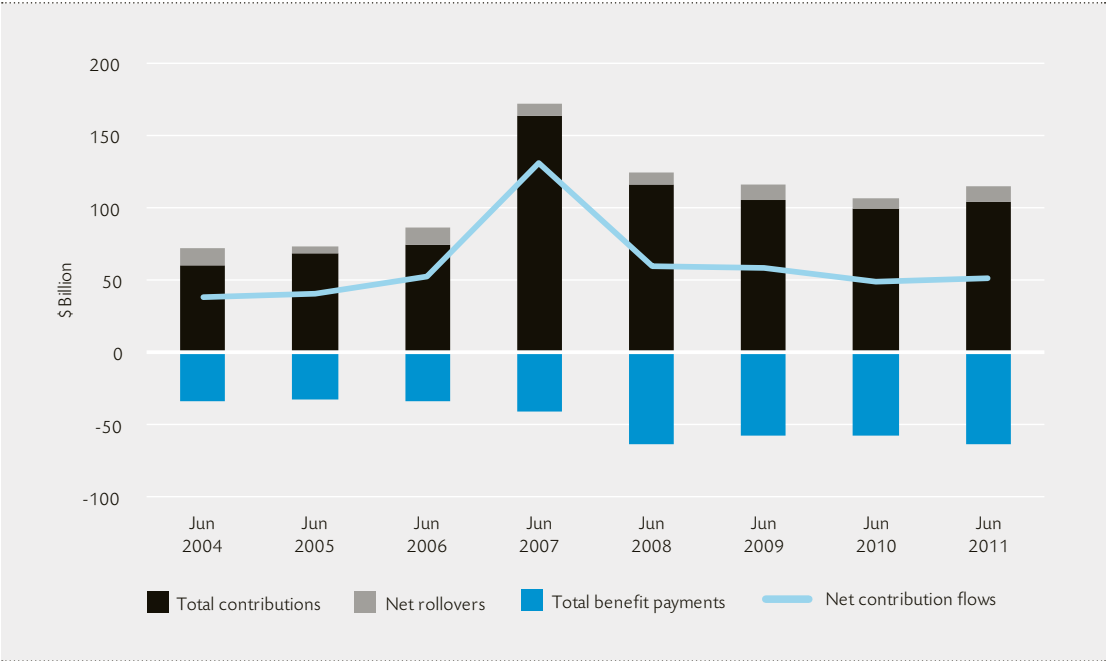
Table 4: Total industry contributions – 1 July 2007 to 30 June 2011

Financial year ending	30 June 2008		30 June 2009		30 June 2010		30 June 2011	
	\$ million	%*	\$ million	%*	\$ million	%*	\$ million	%*
Contribution type								
Employer	67,604	58.1	70,392	66.7	68,087	68.1	71,409	68.1
Member	47,415	40.8	33,989	32.2	30,534	30.5	32,534	31.0
Other	1,313	1.1	1,085	1.0	1,358	1.4	874	0.8
Total	116,332	100	105,467	100	99,979	100	104,817	100

Source: APRA *Annual Superannuation Bulletin* – June 2011.

*of total contributions

Figure 4: Net contribution and benefit flow



Source: APRA Annual Superannuation Bulletin – June 2011

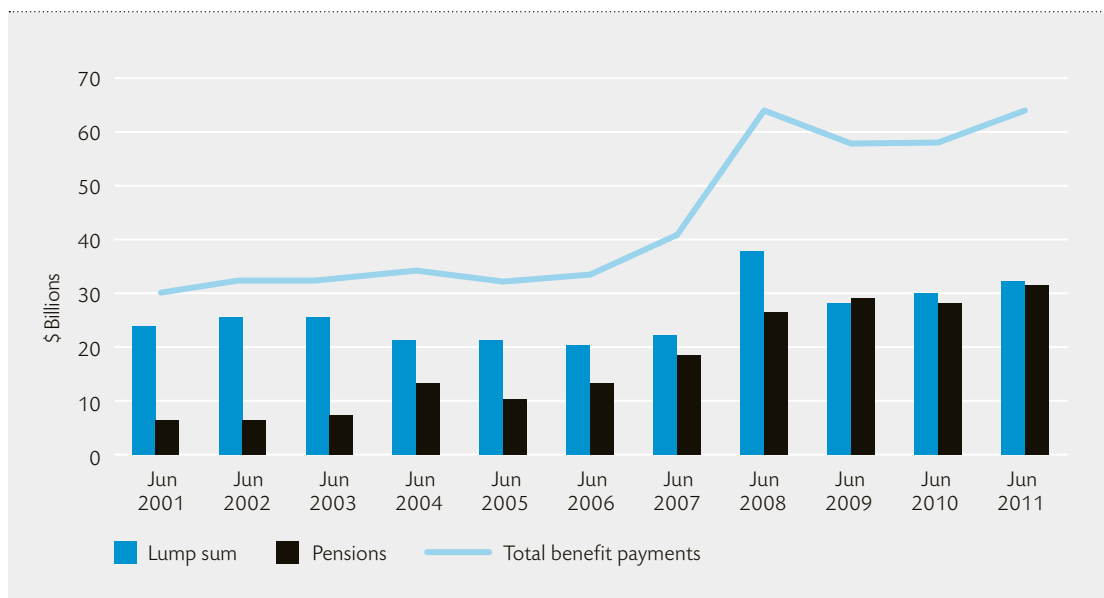
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Figure 4 shows net contribution flows, which have a broadly similar trend to total contributions. However, net flows are tempered by the growing level of total benefit payments as the system matures and workers move from the accumulation to the draw-down phase.

Benefit payments

Total benefit payments to members and beneficiaries increased by approximately 9.1 per cent over 2010/11. This is in line with the recovery in asset values over that year and the preceding year, which contributed to increased superannuation balances.

Figure 5: Total benefit payments 2001 to 2011



Source: APRA Annual Superannuation Bulletin – June 2011

Total benefit payments to members and beneficiaries increased by approximately 9.1 per cent over 2010/11. This is in line with the recovery in asset values over that year and the preceding year, which contributed to increased superannuation balances.

Despite the perception that members generally prefer a lump sum on retirement, Figure 6 demonstrates that income stream payments are keeping pace with lump-sum payments in dollar terms. The concessional tax treatment of superannuation income streams, the availability of 'transition-to-retirement' income streams, improved pension capital values and reduced relief from the annual aged-based minimum drawn-down requirements are likely to ensure that income stream payments remain a significant part of benefit payments.

The dollar value of benefit payments has risen noticeably since 1 July 2007. The contributing factors have been the increasing percentage of the population moving to the retirement phase and the growing popularity of retirement and transition-to-retirement income streams. The removal of reasonable benefit limits (RBL) on the concessional tax treatment of superannuation benefits from 1 July 2007 provided greater flexibility in how members received their payments. During 2007/08, the social security incentives to take at least some part of retirement benefits as a complying income stream/annuity were also removed.

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Table 5: Benefit payment comparison between large and small funds

	Large funds \$ billion	Small funds* \$ billion	Total \$ billion
Lump sums	25,167	6,821	31,988
Pensions	19,905	11,757	31,662
Total	45,072	18,578	63,650

*Small funds include small APRA funds, single-member approved deposit funds and ATO-regulated self managed superannuation funds.

Source: APRA *Annual Superannuation Bulletin* – June 2011

Table 6: RSE licensee population

Class of RSE licensee	31 December 2010	31 December 2011
Acting trustee	12	12
Extended public offer	16	17
Non-public offer	121*	108*
Public offer	92	89
Total*	241	226

Source: APRA register of RSE licensees

* The total includes four groups of individual trustees.

Licensing

Registrable Superannuation Entity (RSE) licences are issued by APRA. Since 1 July 2006, all trustees of APRA-regulated superannuation funds are required to hold an RSE licence. At the commencement of the licensing regime, 307 licences were issued but that number had fallen to 226 by end-December 2011. At the time of preparation of this article there were 216 RSE licensees.

Key supervisory issues

Data management

Correct and secure data are crucial to the successful operation of superannuation. If they are to meet their obligations to members in terms of calculating and recording benefits, trustees must have a data management strategy.

The nature of superannuation is such that many trustees outsource functions such as administration and custodianship of assets to third-party providers that are not regulated by APRA. APRA regularly reinforces the message to trustees that responsibility for and ownership of their funds' data is theirs and not that of their third-party providers. Trustees are regularly questioned about their own activities with their data and data management.

In this period of fund mergers and acquisitions, it is essential that the transfer of data is a major consideration for the entities involved.

APRA has voiced its concerns with data management at industry forums and communicated them in other APRA external publications. In April 2012, following industry consultation, APRA released two prudential practice guides in the area of contribution and benefit accrual standards, and payment standards, that encourage trustees to develop a data reliability framework. This guidance material also outlines APRA's expectations on data storage and processing systems.

In this period of fund mergers and acquisitions, it is essential that the transfer of data is a major consideration for the entities involved, especially if the transfer is to a new administration platform. Improved quality of data can also reduce the need for administration 'black-outs' while fund mergers are finalised.

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Liquidity

Though the industry has remained in a largely cash flow positive position, APRA's supervision continues to focus on trustees' liquidity risk management. APRA has stated elsewhere that liquidity management in superannuation has not reached the same level of sophistication that APRA observes in the other industries it supervises. APRA has provided guidance to trustees on its expectations for liquidity management and has observed improvements in this area. Practices where further improvement is to be encouraged include the ongoing monitoring of liquidity, contingency planning, the adequacy of stress testing and the management of liquidity pressures due to legislative issues such as account consolidation.

Frozen funds

In response to the global economic crisis, the Government in October 2008 introduced a guarantee on the deposits and wholesale funding of authorised deposit-taking institutions (ADIs) in Australia. This guarantee created a demand for products that it covered but also resulted in a rapid increase in the demand for redemptions from investments in a number of registered managed investment schemes (MISs) not covered by the guarantee.

Under the weight of redemption requests, some MISs were not able to realise sufficient assets to satisfy redemption requests within the timeframe of their constitutions and many MISs legally placed a freeze on redemptions.

Under the terms of the *Corporations Act 2001*, a registered MIS is required to freeze redemptions if less than 80 per cent of the value of the scheme is held in 'liquid' assets such as cash, bills, marketable securities or other property that the responsible entity reasonably considers able to be realised for its market value within the period provided for in the scheme's constitution for satisfying withdrawal requests. This same carve out, however, does not apply to trustees of RSE licensees that invest in these schemes. Trustees are not at liberty to halt portability requests and benefit payments because the underlying investments have become frozen or illiquid. Trustees must meet their obligations to their members in terms of benefit payments, switching requests and rollover requests, and they must manage liquidity for their funds accordingly. Trustees are, however, able to apply to APRA for relief from the portability requirements of the *Superannuation Industry (Supervision) Act 1993*.

Portability

APRA is now completing its assessment the fourth cycle of applications for portability relief. Overall, it appears the same group of retail funds that have continually sought and received relief since September 2008 have again applied. APRA has been actively contacting trustees with existing relief seeking additional information on the status of the funds and the redemption policy of the underlying MIS or listed security. APRA has noted that some MIS restructures have resulted in new monies being accepted into illiquid offerings, which may be at odds with the portability requirements.

There are new trends evident in recent portability relief applications. These include:

- portability relief being requested for ASX-listed securities, as a result of the company either going into administration or being delisted/suspended; and
- freezes on benefit payments (in some cases only part payments) for affected members as a consequence of a merger or transfer and, to a lesser extent, a change of administrator.

APRA expects trustees to be active in their dealings with the responsible entities of the MISs and attempt to reach a suitable outcome for their members. There are lessons to be learned from cases where trustees invested in MISs that did not satisfy the fund's liquidity profile. Investment managers and trustees are acting on withdrawal windows or at least assessing whether remaining in the investment is in the members' best interests.

Exposure to unlisted or private market assets

Some superannuation funds hold significant levels of unlisted or private market assets. These assets are a potentially attractive proposition to trustees due to the longer term nature of their earnings profile and relatively lower levels of volatility as they are not valued as often as listed securities. However, holding unlisted/private market assets may add to pressures on the liquidity requirements of funds; the characteristics of these assets may include a long lockup period as well as ongoing financial commitments. More liquid assets may have to be sold to support holdings of unlisted/private market assets.

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Mergers and acquisitions

The number of APRA-regulated large funds has been declining for some time. Increased regulation and growing complexity in the operation of superannuation funds have led to corporate funds transferring to master trusts and industry funds, and like-minded industry funds merging. There have also been some takeovers in the banking and wealth management sector. Increasing expectations on funds and trustees to be cost-effective are likely to lead to further fund mergers and acquisitions, and reorganisation within wealth management groups, in order to benefit from scale efficiencies.

The recently completed Super System review and the Government's Stronger Super reforms are also encouraging trustees to actively consider the scale of their operations. Under current legislative proposals, trustees offering a MySuper product will need to conclude annually that the product has sufficient scale to provide optimal benefits for their members.

There are now instances of already merged entities seeking further merger partners. As a clearer picture emerges of the requirements of MySuper and the heightened requirements of trustees, it is expected that fund mergers and successor fund transfers will remain part of the superannuation landscape for some time to come.

APRA's experience with fund mergers and acquisitions

APRA expects trustees to be mindful of the challenges involved when funds are merging, including operational risks, the need to ensure sound governance and the need to address the sometimes complicated logistics while still remaining focussed on business-as-usual issues.

APRA has no powers to either approve or decline mergers. APRA's supervision is mindful of the risks posed by fund consolidation and APRA has encouraged open dialogue between the merging entities, and with APRA, so that any potential or actual issues are identified early.

To date, APRA has experienced varying levels of cooperation and involvement from merging entities. Some entities have been willing to keep APRA informed of progress and how project plans are being managed and key milestones achieved, or consulting APRA if there are potential compliance issues. However, there have been other merging entities that prefer to keep APRA informed on a needs-to-know basis and APRA is only becoming aware of decisions at short notice.

Although the funding positions of defined benefit funds have improved since the depth of the global financial crisis, there are still a number of funds and sub-funds in unsatisfactory financial positions.

Mergers where an open dialogue with APRA has been maintained have typically progressed smoothly. This outcome may also be the result of the merging entities sharing outsource providers such as administration and insurance and having a like-minded purpose and culture in respect of their membership. The ability to forgo office and title for the benefit of the merger also aides its smooth progression. The more diligent entities are also undertaking post-merger reviews to address gaps with issues such as data, custodianship and the transfer of assets.

Defined benefit fund solvency

Continuing investment market volatility and potential stresses on sponsoring employers ensure that the monitoring of defined benefit fund solvency remains a focus of APRA's supervisory activities. Although the funding positions of defined benefit funds have improved since the depth of the global financial crisis, there are still a number of funds and sub-funds in unsatisfactory financial positions. These entities receive close APRA attention. APRA seeks to ensure that trustees are working with employer sponsors and actuarial advisers to fulfil their obligations with regards to their funding plans. The greater majority of employers appear to be complying with rectification plans to restore funding positions but there also seems to be a willingness to transfer defined benefit members, and convert funds, into defined contribution arrangements.

Commonly, defined benefit funds are funded to a vested benefit index (VBI) of 100 per cent. Although this meets immediate funding objectives, it leaves little room for future economic or investment shocks that may cause asset values to deteriorate. These could be the very times when employer sponsors, perhaps at their most stressed financially, could be called upon to address any funding deficiencies.

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Market and investment risk**Risk management**

The management of investment risk also remains a key focus of APRA's supervision of the superannuation industry.

Supervisory activities, including reviews from APRA's market risk teams, suggest that trustees demonstrate a sound level of understanding in risk management, although there is always room for improvement in the implementation of risk management frameworks. Some of the specific issues APRA has identified include:

- reviews of investment strategies are not consistently undertaken and/or trustee-adopted strategies are not properly implemented and monitored;
- investment management roles, in terms of duties and accountabilities, need to be clearly prescribed;
- the process for selection and performance review of investment managers may require more formalisation, including retain and terminate decisions;

- 'downstream' risks at the asset allocation level are not always fully addressed. Risks in relation to a decline in asset values may have been addressed but policies and procedures for managing ratings downgrades, currency risk and asset liability mismatch risk may be lacking;
- some deficiencies have been noted in the risk reporting provided to trustee Boards. In some cases there was a lack of monitoring of positions against Board-approved limits and attribution analysis; and
- although processes around the management of valuation risk by trustees were broadly adequate, weaknesses were identified around the use of models and alternative valuation techniques, including operational parameters and triggers for modelling.

APRA's supervisory activities have not noted any material deterioration in the area of unit pricing but trustees will need to remain vigilant to potential risks given the complexity of this function.

Fund promoters

APRA wrote to trustees in November 2011 to outline its expectations regarding agreements between RSE licensees and fund promoters. The poor performance of a fund promoter has the potential to impact significantly on the RSE and/or the RSE licensee. APRA would expect any agreements between RSE licensees and fund promoters to be treated as a 'material business activity' that requires compliance with the Outsourcing Standard.

APRA expects trustees to review their existing arrangements with fund promoters to ensure they comply with the Outsourcing Standard. Where existing arrangements do not comply, APRA expects RSE licensees to undertake immediate steps to ensure compliance.

Other industry developments

Standard risk measure

In 2010, APRA released brief guidance on the labelling of investment risk for investment options. APRA expects trustees to develop a classification process so that members can distinguish the level of investment risk of the different investment options offered. The Association of Superannuation Funds of Australia (ASFA) and the Financial Services Council (FSC) conducted a joint working party and issued a discussion paper on this topic. In August 2011, ASFA and the FSC released new industry guidelines to standardise the disclosure of investment risk in superannuation funds.

The guidelines are based on the expected number of negative annual returns an option will experience over any 20-year period. Under the guidelines, superannuation funds will provide a standard risk measure ranging across seven bands from 'very low' to 'very high' for each of the investment options they offer (Table 7).

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Table 7: Standard risk measure

Risk band	Risk label	Estimated number of negative annual returns over any 20 year period
1	Very low	Less than 0.5
2	Low	0.5 to less than 1
3	Low to medium	1 to less than 2
4	Medium	2 to less than 3
5	Medium to high	3 to less than 4
6	High	4 to less than 6
7	Very high	6 or greater

The Government's Stronger Super reforms will raise requirements on trustees in respect of governance, risk management, reporting and their management of default members.

APRA expects that trustees will be able to demonstrate:

- they have a proper basis for the conclusions reached;
- they can justify the classification decision (e.g. through modelling) and not simply make an assertion; and
- they have access to robust data, systems and processes that substantiate the decisions to categorise the investment strategies as they have.

Both APRA and ASIC will incorporate this standard risk measure into their activities. APRA will examine the trustee's processes that lead to the determination of risk categories while ASIC will monitor the trustee's adherence to disclosure obligations.

Conclusion

The superannuation industry regulated by APRA is undergoing a period of considerable change. The Government's Stronger Super reforms will raise requirements on trustees in respect of governance, risk management, reporting and their management of default members. Continuing fund mergers and a further decline in the APRA-regulated fund population are likely consequences. New provisions for the consolidation of accounts are expected to see total account numbers decline over the short to medium term.

With the increase in the Superannuation Guarantee rate, inflows into superannuation are likely to remain largely positive over time. However, ongoing economic uncertainty and market volatility will require trustees to remain clearly focussed on managing the risks associated with investing on behalf of their beneficiaries.

APRA'S IMPLEMENTATION OF THE STRONGER SUPER REFORMS

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Until the introduction of the Superannuation Guarantee from 1 July 1992, superannuation coverage was limited to a small percentage of employees. Since then, coverage has expanded to most employees, and the compulsory contribution amount by employers for all employees has risen from three per cent of salary to nine per cent. Recently passed legislation will see contribution rates increase to 12 per cent of salary by 2019-20.

In 2007, APRA published statistics on 10 years of superannuation data from 1996-2006.¹ This 10-year survey highlighted the quadrupling of superannuation assets from \$245 billion in 1996 to \$912 billion in 2006. APRA's latest statistical publication shows superannuation assets are now around \$1.3 trillion.² The number of APRA-regulated superannuation entities with more than four members fell consistently over the survey period, from 4747 in 1996 to 872 in 2006, and this decline has continued, with 347 large APRA-regulated funds in June 2011 (excluding pooled superannuation trusts, approved deposit funds and eligible rollover funds).

¹ www.apra.gov.au/Insight/Pages/APRA-Insight-Issue-2-2007.aspx

² www.apra.gov.au/Super/Publications/Pages/quarterly-superannuation-performance.aspx

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What are the reforms?

On 29 May 2009, the Government commissioned the Super System Review³ to comprehensively examine and analyse the governance, efficiency, structure and operation of Australia's superannuation system. The Review was conducted with a focus on the concepts of the best interests of beneficiaries and maximising retirement incomes for Australians. The Review's objectives were also to improve regulation of the superannuation system whilst also reducing business costs within the system. The Review's final report was provided to the Government on 30 June 2010.

In its announcement ('Stronger Super') responding to the recommendations the Government indicated it had aimed at delivering better outcomes for members and their employers through a range of measures. The Government concluded it was appropriate to enhance the requirements and responsibilities for superannuation trustees and provide APRA and other regulators with improved tools and powers.⁴

The Review's objectives were also to improve regulation of the superannuation system whilst also reducing business costs within the system.

The Government grouped the reforms into four broad categories: MySuper, SuperStream, Governance and Self-managed superannuation funds (SMSFs). Major changes to be implemented under each of these categories are outlined below:

- **MySuper** – introduction of a new, low-cost, simple default option by 1 July 2013. Registrable Superannuation Entity (RSE) licensees must be authorised by APRA to offer a MySuper product;

³ www.supersystemreview.gov.au/content/terms_of_reference.aspx

⁴ <http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications.htm>

- **SuperStream** – auto-consolidation of some accounts to facilitate the reduction of duplicate accounts in the superannuation system, and data and e-commerce standards for contributions and rollovers that apply to employers and trustees of APRA-regulated funds and SMSFs;
- **Governance** – introduction of prudential standards for superannuation, enhanced trustee and director obligations, and introduction of an operational risk financial requirement; and
- **SMSFs** – introduction of SMSF auditor registration and limitations on related-party transactions. As APRA has no role with SMSFs, this paper will not discuss the SMSF reforms.

The timetable set by the Government for the introduction of all of these reforms is tight. APRA is closely involved in implementing two of these four reform categories (MySuper and Governance) and will have an ongoing supervisory role in a third (SuperStream). APRA has established its implementation timetable to meet the Government's timeframe and remains on track to meet its timetable.

The Government is introducing changes to the legislation in several tranches.⁵ The first tranche of legislation, the Superannuation Legislative Amendments (MySuper Core Provisions) Bill 2011 was introduced to Parliament on 3 November 2011 and referred to the Parliamentary Joint Committee on Corporations and Financial Services (the PJC). The second tranche of legislation, the Superannuation Legislative Amendments (Trustee Obligations and Prudential Standards) Bill 2012 was introduced to Parliament on 16 February 2012 and also referred to the PJC. The PJC tabled its report on both tranches on 19 March 2012. In addition, the Superannuation Legislation Amendment (Stronger Super and Other Measures) Bill (No. 2) (2012): Superannuation data and payments standards was released for public comment on 9 February 2012. It is expected that further tranches of legislative change relating to Stronger Super will be forthcoming throughout 2012.

⁵ <http://strongersuper.treasury.gov.au/content/Content.aspx?doc=legislation.htm>

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APRA, the Australian Securities and Investments Commission (ASIC) and the Australian Taxation Office (ATO) have distinct responsibilities for implementing areas of the Stronger Super reforms. The ATO is responsible for implementing the SuperStream reforms and is doing so in consultation with APRA on areas where APRA will have future supervisory responsibility. ASIC is implementing auditor registration for SMSFs as well as disclosure-related reforms, which have some overlap with APRA's data collection proposals. As part of Stronger Super, the Productivity Commission has announced an inquiry into default superannuation funds in modern awards.⁶ This inquiry is due to give its final report to the Government in October 2012.

In addition to Stronger Super, changes to the regulation of the provision of financial advice are underway with the Future of Financial Advice (FOFA) reforms. These changes may also impact on the operations and activities of RSE licensees and are intended to be introduced on a similar timeframe to Stronger Super.

For RSE licensees, Stronger Super may require changes to administrative and IT systems, outsourcing arrangements, governing rules, trustee policies and their documentation, and investment strategies. APRA urges RSE licensees to actively engage with the reforms now to allow for considered implementation of the changes.

What is APRA implementing?

APRA has established a project for the implementation of Stronger Super. This project has been underway for 12 months and will continue throughout the introduction of the reforms. APRA is committed to a timely and orderly introduction of the reforms.

For APRA, there are three major areas of implementation:

- introducing prudential standards and accompanying prudential practice guides (PPGs) for superannuation;
- authorising MySuper products; and
- revising the APRA data collection to incorporate information needs inherent in Stronger Super and provide transparency and comparability of MySuper products.

⁶ www.pc.gov.au/projects/inquiry/default-super

APRA's supervision visits to RSE licensees as well as liaison meetings in Sydney and Melbourne provide an opportunity for discussion of its implementation of Stronger Super and RSE licensee preparedness for the changes.

APRA has already engaged with the superannuation industry via a variety of workshops, seminars and presentations in most capital cities around the country and will continue to do so during each of the consultation periods in 2012. APRA's supervision visits to RSE licensees as well as liaison meetings in Sydney and Melbourne provide an opportunity for discussion of its implementation of Stronger Super and RSE licensee preparedness for the changes.

Key elements of prudential standards for superannuation

In September 2011, APRA released a discussion paper, *Prudential standards for superannuation*⁷. APRA received 41 submissions in response to this paper on a broad range of topics. APRA is currently drafting prudential standards that broadly follow the proposals in the discussion paper and will reflect consideration of the submissions received.

⁷ www.apra.gov.au/Super/Pages/superannuation-prudential-standards-consultation.aspx

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Table 1: Timetable for APRA's implementation of reforms

Activity	Dates
Consultation on discussion paper <i>Prudential Standards for Superannuation</i>	28 September 2011 to 23 December 2011
Response to submissions and consultation on draft prudential standards	April 2012 to July 2012*
Consultation on MySuper authorisation process	May 2012 to July 2012*
Consultation on revised data collection for superannuation	July 2012 to September 2012*
Release final MySuper authorisation process	November 2012*
Release final prudential standards	December 2012*
Consultation on draft PPGs	December 2012 to March 2013*
Applications for MySuper authorisation can be submitted	January 2013*
MySuper products available to members	1 July 2013
Release final reporting standards for data collection for superannuation	July 2013*
Release final PPGs	July 2013*
First data collection under new standards	October 2013* for the July – September 2013 reporting quarter

* These dates are estimates

The Government decided that APRA will be provided with prudential standards-making power as part of Stronger Super. APRA views the introduction of prudential standards for superannuation as a very important reform. APRA has had prudential standards-making power for all authorised deposit-taking institutions (ADIs) since 2000, general insurers since 2002 and life insurers since 2006. This reform provides APRA, as an integrated prudential regulator, the same regulatory tools for each of its industries and enables it to more effectively supervise the behaviour of regulated institutions.

The Superannuation Legislative Amendments (Trustee Obligations and Prudential Standards) Bill establishes a definition of prudential matters for the new s. 34C(4) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and provides APRA the power to make prudential standards in relation to prudential matters in the new s. 34C(1).⁸ The definition of prudential matters is broadly aligned with the definitions of prudential matters for other APRA-regulated industries and covers the conduct of RSE licensees, the appointment of auditors and actuaries and the conduct of audit and actuarial investigations.

The prudential matters relating to the conduct of each RSE licensee include:

- to protect the interests of beneficiaries and to meet the reasonable expectations of beneficiaries;
- to keep itself in a sound financial position;
- not to cause or promote instability in the Australian financial system; and
- the conduct of its affairs with integrity, prudence and professional skill.

Proposed framework

Stronger Super confirms the approach of the superannuation benefits of Australians being maintained within a trust structure, with additional legislative requirements reinforcing and extending the trust law duty of RSE licensees to act in the best interests of their beneficiaries.

The proposed framework for the prudential regulation of superannuation reflects the three-tiered approach that applies in other APRA-regulated industries, namely:

- primary legislation, being the SIS Act, which outlines high-level obligations, high-level definitions and enforcement powers;

⁸ <http://strongersuper.treasury.gov.au/content/Content.aspx?doc=bills/trustee.htm>

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- subordinate legislation, in the form of *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations) and prudential standards, which contain more detailed requirements on prudential matters; and
- guidance material, in the form of PPGs, that supports the obligations and requirements contained in the primary and subordinate legislation and, in particular, APRA's prudential standards.

Prudential standards will form part of RSE licensee law⁹ and APRA can currently issue directions to an RSE licensee to comply with RSE licensee law.

A number of factors have influenced APRA's proposed content for prudential standards for superannuation:

- the Government has referred to APRA a number of specific reforms to be implemented in prudential standards. Further, there are a number of proposed amendments to the SIS Act that will be supported by the principles-based requirements that APRA will determine in prudential standards;
- APRA will harmonise the requirements applying across APRA-regulated industries, where appropriate;

- the absence of a prudential standards-making power in superannuation has meant that a number of prudential requirements are currently sited in various locations such as the SIS Act, operating standards in the SIS Regulations and licence conditions. Subject to the necessary amendments to the SIS Act and SIS Regulations being made, APRA proposes to bring those obligations into prudential standards where it can. In a number of areas, the substance of the prudential requirements will not change even though the location and presentation of the requirements will be amended; and

- APRA's previous guidance to industry has taken many forms, such as PPGs, circulars, letters and frequently asked questions. APRA will review the entire suite of guidance material. Some matters will become requirements in the prudential standards and the remainder of the guidance material that is still relevant will be incorporated into PPGs.

In determining prudential requirements, APRA recognises that the nature, size and complexity of institutions vary across any industry. Prudential standards allow for appropriate flexibility, avoiding a 'one-size-fits-all' approach to regulation. APRA's emphasis is on sound prudential outcomes, without specifying or prescribing the exact manner in which those outcomes are to be achieved.

⁹ See SIS Act s. 10(1) for a definition of RSE licensee law. The Superannuation Legislative Amendments (Trustee Obligations and Prudential Standards) Bill includes an amendment to this definition to include prudential standards.

Suite of prudential standards

APRA's proposed prudential standards for superannuation will support and expand on the legislative obligations with requirements for, among other things, frameworks, policies and documented processes that RSE licensees need to have in place. In its other industries, APRA's prudential standards can be broadly classified as behavioural standards and technical standards and it proposes to take the same approach in superannuation.

APRA recently released cross-industry prudential standards relating to governance, fitness and propriety, outsourcing and business continuity management (BCM).¹⁰ These cross-industry prudential standards apply to ADIs, general insurers, life companies (including friendly societies) and APRA-regulated non-operating holding companies. APRA does not propose to apply these cross-industry standards to the superannuation industry at this stage. APRA proposes, however, to harmonise the requirements for superannuation with these cross-industry standards where appropriate.

APRA's emphasis is on sound prudential outcomes, without specifying or prescribing the exact manner in which those outcomes are to be achieved.

Table 1 compares the proposed suite of prudential standards for superannuation with the behavioural prudential standards applying to the other APRA-regulated industries.

Technical standards cover risks that are specific to each industry and hence are most appropriately addressed in prudential standards that are specific to each industry.

For details about APRA's proposals for each of the prudential standards, refer to the discussion paper *Prudential Standards for Superannuation*. APRA expects to release a response paper and draft prudential standards for consultation in April 2012.

¹⁰ *Prudential Standard CPS 510 Governance (CPS 510), Prudential Standard CPS 520 Fit and Proper (CPS 520), Prudential Standard CPS 231 Outsourcing (CPS 231) and Prudential Standard CPS 232 Business Continuity Management (CPS 232)*

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Table 2: Proposed prudential standards for superannuation and behavioural prudential standards that apply to other APRA-regulated industries

	Superannuation (proposed)	Authorised deposit-taking institutions	General insurers	Life companies
Behavioural standards				
Governance	SPS 510	CPS 510	CPS 510	CPS 510
Fit and Proper	SPS 520	CPS 520	CPS 520	CPS 520
Outsourcing	SPS 231	CPS 231	CPS 231	CPS 231
Business Continuity Management	SPS 232	CPS 232	CPS 232	CPS 232
Risk Management	SPS 220		GPS 220, 221	LPS 220
Audit and Related Matters (actuarial, where relevant)	SPS 310	APS 310	GPS 310, 311	LPS 310, 320
Standards specific to superannuation				
Investment Governance (SPS 530), Conflicts of Interest (SPS 521), Defined Benefit Matters (SPS 160), Operational Risk Financial Requirement (SPS 114), Insurance in Superannuation (SPS 250), MySuper Transition (SPS 410)				

Guidance material

APRA recognises that substantial guidance material to support the prudential standards is essential. Many of the submissions to the September 2011 discussion paper provided suggestions of particular areas where guidance from APRA would assist the industry.

For each of the prudential standards, APRA expects to issue at least one PPG, drawing on existing APRA guidance material as well as industry better practice. The PPGs will provide guidance on how RSE licensees might best satisfy the requirements of the prudential standards.

As with the development of the prudential standards, APRA will consult widely with the industry and other relevant stakeholders on the content of the PPGs. APRA expects to release draft versions of PPGs for industry comment prior to the commencement of MySuper authorisation in early 2013.

Key elements of MySuper authorisation

The Government has decided to introduce MySuper, a new superannuation product for default contributions aimed at delivering better outcomes for members, with standardised fee categories and a diversified investment strategy.

RSE licensees must be authorised by APRA to offer MySuper products. These products cannot be offered prior to 1 July 2013, and from 1 October 2013 most employers must make default Superannuation Guarantee contributions to an RSE offering a MySuper product. Default balances must be moved into a MySuper product by 1 July 2017.

The Superannuation Legislative Amendments (MySuper Core Provisions) Bill outlines the three provisions under which an RSE licensee may apply to APRA for authorisation to offer a MySuper product:

- s. 29T of the SIS Act for a single MySuper product in an RSE;
- s. 29TA of the SIS Act, which allows a provision for multiple MySuper products in an RSE where there is material goodwill associated with multiple brands within the RSE; and

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- s. 29TB of the SIS Act, which allows a provision for multiple MySuper products in an RSE to be tailored for members who are employees of an employer with more than 500 employees.

The RSE licensee's authorisation will specify the MySuper products that the RSE licensee is permitted to offer.

Under the terms of the Bill, an application for authorisation must be in the approved form and must provide all required information. It must be accompanied by an up-to-date copy of the entity's governing rules. APRA expects to provide an online application process.

APRA expects to focus its authorisation work on the single MySuper products in the first instance and follow with large employer exemption MySuper products. For the latter products, RSE licensees need to be satisfied with the sustainability of the product, in particular the likelihood of an employer maintaining more than 500 employees. As such, APRA expects to see applications from RSE licensees for such MySuper products for employers with substantially more than 500 employees, rather than employers close to the 500 employee threshold.

In order to authorise a MySuper product, APRA must be satisfied that the trustee is likely to comply with the enhanced trustee obligations¹¹ and fee rules¹² for MySuper products. As such, APRA's authorisation process will assess the content of the documents submitted in the application as well as have regard to the past conduct of an RSE licensee.

The characteristics of a MySuper product are detailed in s. 29TC of the SIS Act and include:

- a single diversified investment strategy for the product;
- all product members to have access to the same options, benefits and facilities;
- investment returns to be allocated proportionately to product members;
- any employer fee subsidisation to not favour some product members over others;
- no limitations on the kind or source of contributions;
- any movement of member benefit must be either by consent, or into another MySuper product or otherwise as permitted or required by a law of the Commonwealth; and

¹¹ SIS Act ss. 29VN, 29VO, 51A, 52 and 52A

¹² SIS Act, s. 29V

- no pension may be paid from assets held within the MySuper product.

APRA expects to release a consultation package on the MySuper authorisation process, including a draft approved form, in May 2012.

APRA encourages RSE licensees to submit draft applications for MySuper authorisation, as a way of facilitating smooth processing of applications during 2013. APRA is planning to have applications processed by the supervisors for each RSE licensee who are familiar with its current operations. A centralised team will also be involved to maintain a consistent approach to authorisation across APRA.

Transition to MySuper

APRA proposes to outline in *Prudential Standard SPS 410 MySuper Transition* requirements for all RSE licensees during the transition period from 1 July 2013 to 1 July 2017, by which date all accrued default amounts must be in a MySuper product except in limited circumstances.

This standard is expected to include, at a minimum, requirements:

- to identify the accrued default amounts of members;
- for those RSEs that hold accrued default amounts to develop and execute a transition plan addressing the movement of accrued default amounts to a suitable MySuper product; and
- to provide specified reporting to APRA.

The complexity of transition arrangements is likely to depend on the structure of an RSE licensee's operations and MySuper product (if any). Where a current default option is converted to a MySuper product, transition to MySuper may be relatively straightforward as accrued default amounts would not need to be moved to another investment option, but could stay where they are. More complicated situations may arise where there are multiple current default options, new MySuper products distinct from current default options are being created or an RSE licensee is not authorised to offer a MySuper product. In these scenarios, accrued default amounts would need to be transferred into a MySuper product.

APRA also expects to introduce reporting requirements to monitor the transition to MySuper. These requirements are likely to cover data items related to the transfer of accrued default amounts, and will be consulted on in 2012.

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Key elements of data collection

In May 2009, APRA consulted on proposed amendments to the reporting obligations for superannuation.¹³ These proposals were put on hold pending completion of the Super System Review. APRA has recommenced its work on enhanced data collection in light of the data requirements supporting Stronger Super. The revised data collection proposals will be subject to consultation expected in July 2012.

The Super System Review noted that:

'the Australian superannuation system is characterised by a lack of transparency, comparability and, consequently, accountability. There is no standardised methodology for calculating and disclosing relevant fund or investment option information. Members often rely inappropriately on historical investment return data which gives no information about the risk attaching to those returns.'
Chapter 4, page 99

The Review made recommendations on how transparency on outcomes could be improved. The Government supported these recommendations and placed new expectations on APRA's superannuation publications and data collections. In particular, APRA has been asked to:

- develop approaches to publishing investment performance data that would improve transparency, comparability and accountability in relation to fees, costs and investment returns, including for MySuper products; and
- collect data that will allow information to be made available on the operation and efficiency of superannuation funds.

APRA's current data collections are undertaken for prudential purposes, with external statistical publications focusing on information from the data collection for that purpose. Prudential supervision will continue as the primary purpose for APRA's superannuation data. The Government's reform announcements have extended this to include publication of information for use by members and employers in the future:

'To facilitate member and employer comparison of products, APRA will be required to collect and publish data on the performance of MySuper products, including in relation to a fund's underlying investments.' Stronger Super, page 7

¹³ www.apra.gov.au/Super/Publications/Pages/enhanced-superannuation-statistics.aspx

The Government has indicated that, to meet these expectations, the *Financial Sector (Collection of Data) Act 2001* will be changed to enable the collection of data by APRA for publication purposes.

The current data collection has not been changed since 2004, and the May 2009 discussion paper suggested an expanded data collection that would assist APRA supervisors to achieve a better understanding of, among other things, the internal structure of funds, investment performance of funds and non-investment drivers of member benefits. The majority of these proposals are still relevant today.

In particular, APRA's current data collection focuses on the whole of the fund. Most information is collected in an aggregated form across all investment options and all sub-funds. APRA's May 2009 consultation proposed collecting data on defined benefit sub-funds and on a subset of investment options. The introduction of MySuper products, and the need to have adequate information published on the performance of these products, further enhances the need for APRA to collect information at a more granular level than currently. This is expected to include information on investment performance and related risk measures, fees, costs, asset allocation and member demographics.

Proposals for data collection to facilitate transparency on other aspects of the reforms include data on the operational risk financial requirement, funding and solvency of defined benefit funds and sub-funds, insurance, the number of accounts per fund and the number of unique tax file numbers associated with those accounts.

APRA is working with ASIC with the aim of using common data items for APRA data collection and RSE licensee disclosure where possible, particularly in relation to MySuper products.

RSE licensee preparedness for Stronger Super

The preparedness of RSE licensees is critical in this time of significant change. All of the Government's reforms that APRA is implementing will be effective by 1 July 2013, a timeframe that will be challenging for both APRA and RSE licensees. APRA remains on target to deliver by that date but, for the reforms to be effective, RSE licensees need to be prepared for these changes.

APRA will continue to consult with the industry during 2012 on four areas: draft prudential standards, MySuper authorisation, enhanced data collection and draft PPGs. APRA encourages RSE licensees to engage with this material by making submissions, attending APRA information sessions and through discussions with their APRA supervisors.

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Although there is still some uncertainty regarding the final legislative changes, the draft proposals released to date provide a clear indication to RSE licensees of the Government's intentions. At this stage, RSE licensees could perform a gap analysis of their current operations against the draft legislative proposals to determine the key areas of relevance to them.

Early preparation for MySuper authorisation is essential prior to the commencement of the authorisation period. For all RSE licensees, regardless of whether they expect to offer a MySuper product, identification of all members who will be affected by MySuper products is an important first step for RSE licensees to understand the impact of MySuper.

A threshold question that all RSE licensees should already be considering is whether or not to offer a MySuper product. For RSE licensees that decide not to, preparatory work can include identifying any members with accrued default amounts that will need to be transferred to a MySuper product.

For RSE licensees that decide to offer a MySuper product, preparations regarding the features of the MySuper product can be undertaken, using the Bill as a basis. Some RSE licensees may be considering the conversion of a current default option into a MySuper product while others may be considering the creation of a new MySuper product.

RSE licensees should also consider, to the extent possible, the number of MySuper product authorisations they will seek. For RSE licensees with multiple RSEs, this could mean deciding whether a MySuper product should be created for each RSE.

Within each RSE, RSE licensees should consider whether a single MySuper product could be white-labelled. APRA's expectation is that RSE licensees would typically apply for one MySuper product authorisation per RSE, and applications for multiple MySuper authorisations within an RSE need to demonstrate clear grounds for suitability.

RSE licensees should consider whether the material goodwill provision (s. 29TA) or large employer provision (s. 29TB) will be relevant for their circumstances and whether they expect to apply for multiple MySuper authorisations within a single RSE. As part of this decision, it will be important to determine how and why each MySuper product will differ as well as the sustainability of employee levels above 500 for large employer MySuper products.

The draft legislation and Government announcements outline the features of a MySuper product that must be identical to all members within the product: the investment strategy (including a lifecycle investment strategy), the investment fees and member services. In addition, there are some features of a MySuper product that may be varied across members, in particular administration fees and insurance, without the need to create a separate MySuper product. A MySuper product can also be white-labelled for different categories of members, potentially reducing the number of MySuper products a RSE licensee may choose to offer.

Preparatory work on documentation is also important to consider now. This can include determining the changes that will be necessary to trust deeds or governing rules to accommodate MySuper products, as well as updating policy documents.

For prudential standards, the preparatory work that RSE licensees can undertake now includes:

- examining the operational risks of its business operations to determine the amount to be held for the operational risk financial requirement;
- updating policies and registers relating to conflicts; and
- reviewing and updating all internal policies – e.g. fit and proper policy, risk management strategy, outsourcing policy, insurance policy, investment strategies and investment management policy, and business continuity plans.

Preparations for APRA's enhanced data collection as well as the introduction of SuperStream could include identifying and addressing data quality and data systems issues.

Conclusion

Twenty years since the introduction of the Superannuation Guarantee arrangements, the Government's reforms involve an update to a broad range of aspects in this \$1.3 trillion industry. APRA is aware that some RSE licensees are already engaged with the reforms but some are less aware of the implications of Stronger Super for their operations.

Over the next year, APRA's supervisory interactions with RSE licensees will include discussion of the reforms and activities that RSE licensees are undertaking to prepare for them. The implementation of the reforms will take time and resources for all RSE licensees. Preparing for that change now rather than waiting is not only prudent practice, it is essential.

Katrina Ellis
*Lead, Super Reform Project
 Policy Development*

INSIGHT INTO SUPERANNUATION RESEARCH

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This article summarises the findings of APRA's research
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into superannuation over recent years and examines the areas
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on which future superannuation research is expected to focus.
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Introduction

APRA maintains a small unit dedicated to research. The research is empirical in nature, using the data APRA collects to identify patterns of behaviour. APRA collects substantial amounts of data, not only to perform supervisory duties in respect of regulated entities but also in its role as a national statistical agency for the Australian financial sector. From the research unit's perspective, the data APRA collects has a third purpose, to provide the raw material for empirical research.

When the research unit undertakes empirical research, it seeks to measure behaviours, identify patterns and test for linkages.

In the superannuation industry, APRA's supervisory focus is ensuring that trustees are aware of their obligations to members and manage the funds in their care prudently in the interests of members. The trustee of a superannuation fund has a moral and legal obligation to act in the 'best interests' of its members. Broadly speaking, 'best interests' are defined by the sole purpose test in the *Superannuation Industry (Supervision) Act 1993* (SIS Act), which focuses upon maximising postretirement benefits. The trustee's ability to form a fund strategy that generates good long-term returns, while operating within reasonable risk bounds, is a critical element in serving any member's best interests.

INSIGHT INTO SUPERANNUATION RESEARCH

In this context, APRA's research efforts in the superannuation industry have been focused on two topics: investment performance and costs, and fund governance. The 'behaviour' of assets under management have also been examined, particularly during the accumulation phase of the superannuation cycle. The research unit is now planning to look more closely at the behaviour of fund members and at the outcomes members are able to realise when they draw down their superannuation assets.

Investment performance and costs

Research Paper: *The Investment Performance of Australian Superannuation Funds*¹ (2003)

APRA's first research paper on investment performance was released in February 2003. Authored by Anthony Coleman, Neil Esho and Michelle Wong, the paper used data drawn from both annual data periodic collections from all APRA-regulated funds and quarterly data collected from larger funds (with assets greater than \$60 million).

Using annual data, the research found that retail and industry funds showed lower returns, lower volatility, and higher expense ratios than public sector and corporate funds;² Table 1 is replicated from the paper. The quarterly data confirmed that high-expense funds generally demonstrate lower returns.

The average return figures above are net of expenses, thus retail funds' high expenses and low returns go hand in hand. While that finding holds no surprise, the high expense ratio shown by industry funds is the opposite of today's state of play. One finding at APRA while producing this paper was that a great many expenses are implicit in the net returns provided by third-party fund managers, and these expenses are not separately reported in APRA's statistics. Since this initial paper, APRA's research has focussed upon net returns, which reflect the actual return to members from their investments. It is not necessary at the net returns level to know the expense and tax contributions to returns; these are captured in the net figure.

¹ www.apra.gov.au/AboutAPRA/Research/Documents/The-Investment-Performance-of-Australian-Superannuation-Funds-Feb-2003.pdf.

² APRA distinguishes between 'public-sector' funds established to provide pension benefits to government employees; 'corporate' funds, to the employees of a single company; 'industry' funds, to unionised workers in a single industry; and 'retail' funds sponsored by banks, insurance companies, and other financial service providers and offered to the public as a commercial proposition.

Table 1: Average annual return and volatility, 1996 – 2002

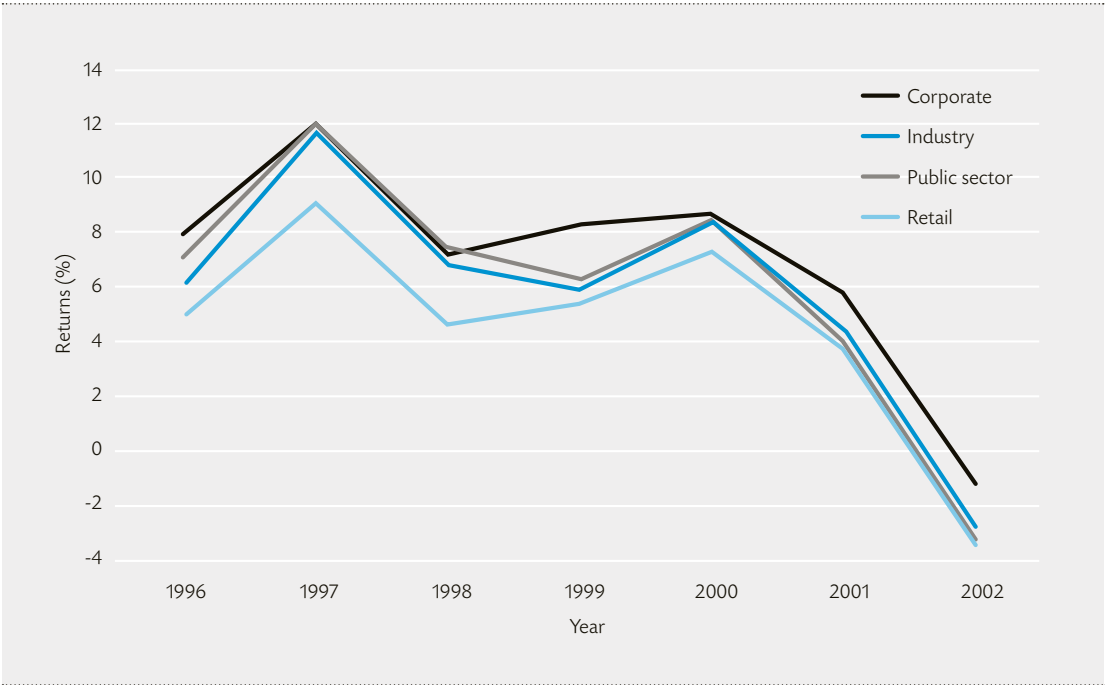
Fund type	Average return	Average volatility	Asset-weighted expense ratio	Number of funds
Corporate	6.96%	6.44%	0.87%	1134
Public sector	5.99% **	5.45% ***	0.58% ***	27
Industry	5.82% ***	5.08% ***	1.30%	100
Retail	4.51% ***	4.85% ***	1.32% ***	96
All funds	6.68%	6.21%	1.07%	1357

Note: *** and ** indicate that the mean for the given fund type is significantly different than the mean of all corporate funds, at the 99 per cent and 95 per cent confidence level, respectively. The statistical significance of the expense ratio relates to the equal-weighted expense ratio, not the asset-weighted ratio set out above.

Prior to this paper, the conventional wisdom was that retail funds might earn lower average net returns but that they were also less risky, and thereby more resilient in poor markets. The data included the 2000/01 downturn in domestic and global equities (see Figure 1) but found, somewhat surprisingly at the time, that retail funds underperformed in all investment climates.

In the superannuation industry, APRA's supervisory focus is ensuring that trustees are aware of their obligations to members and manage the funds in their care prudently in the interests of members.

Figure 1: Average return by fund type, 1996 – 2002



The performance of corporate funds was a relic from a different era, when many employers subsidised their sponsored funds. From 1 July 2004, trustees of regulated superannuation funds started a two-year transition to the 'registrable superannuation entity' (RSE) licensing scheme. Hundreds of corporate schemes chose to wind up or merge their funds, often transferring fund assets to master funds offered by retail trustees. While there is still a rump of low-cost corporate funds, the past eight years have witnessed the commercialisation of the corporate superannuation sector.

Research Paper: *Investment performance, asset allocation, and expenses of large superannuation funds*³ (2008)

Research Paper: *Investment performance ranking of superannuation firms*⁴ (2009)

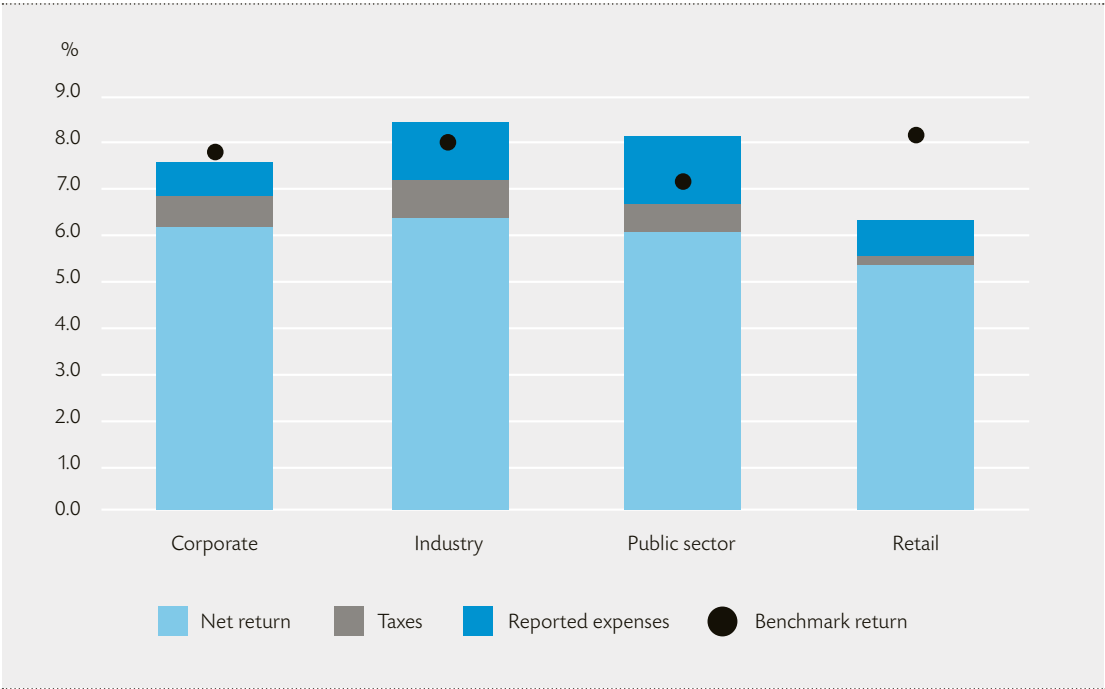
These two papers, published in close succession, grew out of a special data collection in 2006. Superannuation funds with assets greater than \$200 million were required to provide more detailed financial performance and asset-allocation data. A total of 187 responses were lodged; 115 funds provided sufficient data to calculate five-year returns.

The first paper was written by Katrina Ellis, Alan Tobin and Belinda Tracey in October 2008. Using the special collection data, the paper examined pre- and post-tax investment performance, fees and investment expenses, and asset allocations, by reference to the funds' respective default options. (The authors were able to lump corporate, industry, and public sector funds into a single category, 'not-for-profit funds', without losing any meaningful information). After controlling for embedded expenses and taxes, the investing skills of fund managers in the not-for-profit sector were not significantly different – better or worse – from the skills of managers in the retail sector. Yet the net returns of retail funds were significantly lower than their not-for-profit counterparts. The authors attributed this finding to 'higher expenses and taxes, explicit and embedded'.

3 www.apra.gov.au/AboutAPRA/Documents/APRA_WP_LSF_102008-3.pdf.

4 www.apra.gov.au/AboutAPRA/Documents/SA_WP_IPRSF_062009_ex.pdf.

Figure 1: Typical cash flow structure



The second paper, by Wilson Sy and Kevin Liu, was released in June 2009. The researchers here performed a similar analysis, except on whole-of-fund returns and asset allocations, instead of those relating just to the default option. The finding was very similar, that of a statistically significant correlation of higher operational costs and lower net investment performance.

Research Paper: *Risk and return of illiquid investments: a trade-off for superannuation funds offering transferable accounts*⁵ (2011)

A paper on superannuation returns by James Cummings and Katrina Ellis was released in November 2011. The paper observes that most superannuation fund assets are highly liquid. In recent years, however, many superannuation funds have increased their allocations to alternative asset classes, in the expectation that these assets would generate higher returns to compensate for their illiquidity. The paper found that not-for-profit superannuation funds allocate more of their portfolios to illiquid assets and that, in the 2004-2010 period, these investments produced higher risk-adjusted returns. The paper closed with a caution, however, that fund characteristics must be taken into account (e.g. member demographics and projected cash inflows and outflows) so as to maintain adequate liquidity at all times.

5 www.apra.gov.au/AboutAPRA/Research/Documents/SA_WP_RRII_102011_ex.pdf.

Research Paper: *Effect of fund size on the performance of Australian superannuation funds*⁶ (2012)

The Cooper Review⁷ credited economies of scale with the potential for reducing member costs. This came as no surprise, as the issue has long been considered in APRA's analysis of investment performance and costs. The Coleman-Esho-Wong paper in 2003 found that larger funds earned higher gross returns⁸ and enjoyed lower expense ratios. On the costs side, the paper found a steady improvement in expense ratios as assets grew from under \$10 million to \$500 million. Wilson Sy, in an article on small APRA funds,⁹ found a logarithmic decrease in expense ratios with fund size.

6 www.apra.gov.au/AboutAPRA/Documents/SA_WP_IPRSF_062009_ex.pdf.

7 Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, 'Super System Review Final Report', 30 June 2010, available at www.supersystemreview.gov.au/.

8 [permanent URL to be assigned presently]

9 'Cost, Performance and Portfolio Composition of Small APRA Funds', December 2007, www.apra.gov.au/AboutAPRA/Research/Documents/Cost-Performance-and-Portfolio-composition-of-small-APRA-funds.pdf. Funds with fewer than five members which may not comply with the conditions on self-managed superannuation funds can become Small APRA Funds upon the appointment of a licensed trustee.

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APRA's most recent paper on superannuation, by James Cummings, makes economies of scale the focus of the investigation. The data show that not-for-profit funds tend to benefit from scale in three distinct ways: better gross returns due to wider investment opportunities; lower investment expenses derived from a better bargaining position; and lower operating expenses, as fixed costs are spread across a larger pool of assets and more members. However, only savings in operating costs are realised by members of retail funds. The paper also considers the enormous increase in the overall size of the superannuation sector and in the sizes of individual funds (due to both ever-increasing contributions and fund consolidation), and finds no evidence that the benefits of scale have not yet been exhausted.

Summary

These papers, when taken as a whole, deliver a simple but powerful message: on average, the superannuation industry can expect to earn average returns, and only that. Individual fund managers and individual asset classes may outperform others, but these effects are transient. Costs, on the other hand, are persistent. Between a strategy of pursuing gross returns and a strategy of minimising the difference between gross and net returns, the latter appears more fruitful.

Fund governance

The special data collection in 2006 not only enabled the most recent papers on investment performance and costs but also extended to the arrangements by which trustees administer the day-to-day business of their fund. In particular, funds responded to a questionnaire relating to the composition and working practices of the boards of fund trustees, and the identity and compensation of service providers to which operational functions had been outsourced.

Research Paper: *Superannuation fund governance – trustee policies and practices*¹⁰ (2008)

In what was first an article for *Insight*, and then an APRA Working Paper, Wilson Sy, Chris Inman, Neil Esho and Renuka Sane produced an informative survey of the data collection. Most boards were found to comply with accepted good practice, including an emphasis on the education and experience of directors, independent audits and regular self-assessment.

10 www.apra.gov.au/AboutAPRA/Research/Documents/Working-paper-Super-fund-governanceL-Trustee-policies-and-practices-July-2008.pdf.

Literally every fund outsourced at least one function, although not-for-profit funds and retail funds showed markedly different patterns of outsourcing.

The directors of retail funds proved to be roughly five years younger on average than the directors of public sector and industry funds, and with slightly shorter tenures in the job. The most marked difference between the not-for-profit and retail sectors, however, related to work practices. Not-for-profit boards spent considerably more time in meetings and tended to make key decisions themselves based on input from outside consultants. In contrast, retail trustees spent only 40 per cent as much time in meetings and delegated virtually all key decisions to executives employed by other companies within the financial conglomerate.

Research Paper: *Australian superannuation – the outsourcing landscape*¹¹ (2010)

Research Paper: *Australian superannuation outsourcing – fees, related parties and concentrated markets*¹² (2010)

The special collection's data on service providers covered 2,575 outsourcing arrangements, which served as the basis for this pair of papers by Kevin Liu and Bruce Arnold. Literally every fund outsourced at least one function, although not-for-profit funds and retail funds showed markedly different patterns of outsourcing. Not-for-profit funds were more heavily dependent on outsourcing, with 67 of 83 funds using service providers for five or more of the seven functions surveyed. Retail funds not only used fewer service providers, but the service providers they did use were often sister companies within the same corporate group as the trustee. Ignoring related-party providers, 29 of 32 retail funds outsourced three or fewer functions.

¹¹ www.apra.gov.au/AboutAPRA/Documents/SA_WP_ASOL_072010_overview-3.pdf.

¹² www.apra.gov.au/AboutAPRA/Documents/SA_WP_ASOFRP_072010_complete.pdf.

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Table 2: Number of functions outsourced

Fund type	1-2	3	4	5	6	7	Total
Not-for-profit	–	5	11	31	30	6	83
Retail	15	6	5	2	3	1	32
All funds	15	11	16	33	33	7	115

Note: Functions examined consisted of actuarial services, administration, asset consulting, custody, legal services, sales and marketing, and investment management. While the collection data included auditing, because all funds are required to use independent auditors, the arrangements are not considered ‘outsourcing’ for the purpose of this table.

Reviewing the funds’ product disclosure statements and annual reports for the data period, in 70 per cent of the cases public sector funds had not disclosed the fees paid to service providers; the same was true for 55 per cent of the outsourcing arrangements to which industry funds were parties. Retail funds failed to disclose outsourcing fees only a quarter of the time; that said, retail funds on average offer many more investment options and the fees payable to investment managers have been disclosed more frequently than fees paid to other service providers.

The combination of undisclosed fees and related service providers led to the second Liu and Arnold paper, which investigated whether ‘relatedness’ had an impact on fee levels. The paper found that related-party service providers used by not-for-profit funds generally charged no more than independent service providers, whereas service providers related to retail trustees charged fees that were statistically and economically more significant than arm’s length.

Table 3: Estimated annual cost, all functions (including audit)

Median fund	Not-for-profit		Retail	
Total expense	Independent service providers	Related service providers	Independent service providers	Related service providers
Per fund (000s)	\$6,345	\$6,309	\$6,473	\$16,592
Per member	\$185.53	\$184.48	\$189.27	\$485.13
By assets (%)	0.51	0.51	0.52	1.33

Future directions in superannuation research

Retirement outcomes

While investigating investment performance involves focusing on fund assets and investigating fund governance involves focusing on trustees and other service providers, there is also a line of academic research into retirement outcomes. This entails projecting member balances to an anticipated retirement date, estimating the stream of post-retirement benefits, assessing the sufficiency of the benefits to maintain a minimal standard of living, and measuring the satisfaction of retirees in actual retirement outcomes.

APRA can make a contribution to this discussion, particularly in developing an orthodox approach to financial projections and standard metrics to measure the well-being of retired Australians.

Policy matters

The research groups of many regulatory bodies around the world produce policy-related white papers. This is not the province of APRA's research unit, which is dedicated exclusively to empirical research. While this research is expressly not intended to make policy, often the policy implications of the research are quite clear, however.

If fees are demonstrated to have a large impact on retirement outcomes, a reasonable policy response would be to promote lower-cost superannuation products.

Thus, if fees are demonstrated to have a large impact on retirement outcomes, a reasonable policy response would be to promote lower-cost superannuation products. And if outsourcing arrangements involve related parties, it would be a reasonable policy response to incorporate a conflicts policy into the governance framework.

The Government's Stronger Super reforms propose MySuper (a default superannuation product intended to be simple and cost-effective), SuperStream (a package of measures intended to make fund administration easier, cheaper and faster) and improved governance. The flesh on these statutory bones will be produced by APRA, which has already released a discussion paper on its proposed prudential standards in superannuation. Embedded in these statutory and prudential provisions will be a web of intended outcomes. APRA's research unit plans to conduct empirical research as to how effectively those policy outcomes have been realised.

The importance of data

APRA's future empirical research into superannuation will continue to be based on the data collected from the industry. If it is granted new prudential standards-making powers, APRA will have greater responsibility to oversee the day-to-day operations of superannuation funds. For supervisory purposes alone, then, more and different data will need to be collected in the future, which in turn opens up new avenues for research. But as experience shows, the data required for frontline supervision can be different from the data required for empirical research.

APRA's supervisory scope has, to date, focused on the trustee's initially meeting and maintaining their eligibility requirements (such as capitalisation) and on the integrity of the processes established for running the fund. APRA's annual data collection was limited to aggregate stocks and flows; the details of investments and expenses were of minimal prudential concern.

The first research paper on superannuation, the 2003 Coleman-Esho-Wong analysis of investment performance, highlighted the data issues faced by the research unit. The authors calculated returns, volatilities and expenses, but APRA's regular data collection allowed the figures to be compiled on a whole-of-fund basis only, and without regard to asset allocation. As the authors remarked, '[w]hile there would be advantages in examining performance by different asset classes (e.g. bonds, balanced funds, property, international equities), this is currently not feasible due to data limitations'.

The 2006 special data collection, seeking more data from the 187 funds with assets greater than \$200 million, was prompted in large part by an interest in investment activities and the details of fund operations. Without the increased detail, it would have been impossible to produce any of the more recent papers on superannuation.

In what is expected to be the final research effort coming out of the 2006 special data collection, a paper by Kevin Liu and Bruce Arnold links the composition and behaviour of trustee boards with their fund's investment performance. From the corporate finance literature, there is a canon of value-enhancing board characteristics: smaller boards, populated by well-educated directors who are connected (but not too connected) by way of other directorships. This final paper will investigate whether good board characteristics translate into good outcomes for fund members.

However, even the 2006 special collection suffered from shortcomings. Trustees were asked to identify all service providers to whom five per cent or more of the specified functions were outsourced. When examining the fund as a whole, five per cent would be a natural cut-off. The exact details relating to small pockets of assets or minor aspects of larger processes would constitute rounding error, as it were. But in the context of comprehensively measuring fund performance, every dollar of investment and every cent of expense is significant.

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The perfect example of the difference relates to investment management. In the special data collection, 25 of 115 funds lodged no information whatsoever relating to investment management. APRA's regularly collected data, though, showed that all 115 funds used external investment managers. The obvious explanation is the five per cent cut-off. With some funds offering hundreds of investment choices, it would appear that no single manager accounted for five per cent of the fund. Thus the *de minimis* reporting exception caused all investment expenses to vanish.

There is also a more fundamental issue relating to performance data. The superannuation industry is characterised by many layers of investment management. For example, a fund may invest in a pooled superannuation trust that in turn may use multiple investment managers. Master trusts and funds of funds are other examples of multi-tiered arrangements. Multiple layers of investment management also means multiple layers of management fees. However, the usual practice is for net returns only – with fees embedded in those figures – to be reported up to the next level. To conduct accurate and meaningful research into investment performance, APRA has invariably had to estimate and add back these invisible costs.

Future data collections

As already noted, if APRA is granted new prudential standards-making powers, it will have increased supervisory responsibilities. With cost-effectiveness as a stated policy goal, investment performance and expenses become an integral component of this mandate.¹³ These are two very important reasons why the amount and type of data to be collected from superannuation trustees will increase. There is a third reason as well.

Financial stability has moved up dramatically in the list of global regulatory priorities. Since the global financial crisis, the term has been closely associated with the banking sector, and to a lesser extent the insurance sector. When APRA surveys the Australian financial landscape, though, the superannuation sector as well has a key role in financial stability.

¹³ The issue of hidden costs has now become mainstream. According to the Treasury's April 2001 issues paper on data collection, 'the Government will ensure that APRA has the power to collect superannuation fund data on a look-through basis'. http://strongersuper.treasury.gov.au/content/consultations/working_groups/mysuper/IP_datacollection_disclosure_mysuper/downloads/IP_MySuper_datacollection_disclosure.pdf.

Financial stability has moved up dramatically in the list of global regulatory priorities... When APRA surveys the Australian financial landscape, though, the superannuation sector as well has a key role in financial stability.

Australia's retirement income system is built on three pillars: a means-tested age pension, the compulsory superannuation that is the focus of APRA's responsibilities, and private savings. Superannuation assets now exceed Australia's annual gross domestic product. As stated in the 2007 publication highlighting ten years of superannuation data,¹⁴ it is unusual to compare a stock to a flow. What is important, though, is the extent to which second-pillar superannuation earnings support domestic spending (now roughly five per cent of GDP, and projected to double in a generation's time), and at the same time reduce the cost to taxpayers of the first-pillar age pension. Prudential policies, effective investing and transparent and competitive costs in the superannuation sector are therefore important to Australia's public finances. Helping to understand precisely how policies are formulated and implemented will continue to be on the agenda of APRA's research unit.

Bruce R. Arnold
Head of Research

¹⁴ www.apra.gov.au/Insight/Documents/Highlights.pdf.

APRA'S DATA COLLECTIONS

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This article provides an overview of APRA's data collections
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and explains why high-quality and timely data collections
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are essential. It outlines the key users of APRA's data and
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the ways in which they use the data.
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Introduction

APRA supervises institutions within the deposit-taking, general insurance, life insurance and superannuation industries. In performing this role, APRA establishes and enforces prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by supervised institutions are met within a stable, efficient and competitive financial system. An indispensable input in APRA's approach to supervision, and in fulfilling its mandate, is the collection and use of timely and trusted statistics from regulated institutions.

In addition, the data that APRA collect are used by other government agencies, such as the Reserve Bank of Australia (RBA) and the Australia Bureau of Statistics (ABS). APRA's data collections assist these agencies to fulfil their roles while helping to reduce unnecessary reporting burden on institutions.

APRA also collects data from 'reporting' institutions that are not APRA-regulated (e.g. Registered Financial Companies (RFCs)) to ensure that information and analysis on specific areas of Australia's financial system are available to other regulators and policymakers.

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APRA's DATA COLLECTIONS

Almost all of APRA's data collections are legally required to be reported to APRA under the *Financial Sector (Collection of Data) Act 2001* (FSCOD) and APRA's reporting standards. Accordingly, APRA closely monitors timeliness and quality of submissions to ensure the data are available to APRA, the RBA and the ABS by the statutory due dates. Currently, 97 per cent of submissions are received by their due dates and over 99 per cent are submitted within a week of the due date.

To assist institutions in meeting their reporting obligations, APRA has recently undertaken some major initiatives including supporting the Government's Standard Business Reporting (SBR) program and enhancing the process for submitting data electronically to APRA.

Uses of data collected by APRA

Under FSCOD, APRA collects data to assist:

- it in the prudential regulation or monitoring of bodies in the financial sector;
- another financial sector agency to perform its functions or exercise its powers; and
- Government ministers to formulate financial policy.¹

APRA's statistical publications aim to promote understanding and assist research, public discussion on policy issues and well-informed decision-making about the financial system by regulators, policymakers, industry and the public.

An ancillary use of the data collected is APRA's statistical publications. APRA publishes and makes available as much of its data that are useful and able to be released as possible. APRA's statistical publications aim to promote understanding and assist research, public discussion on policy issues and well-informed decision-making about the financial system by regulators, policymakers, industry and the public.

¹ Section 3 of the *Financial Sector (Collection of Data) Act 2001*.

APRA-regulated and other reporting institutions submit data to APRA in 'returns' – a collection of related forms due at the same time, either monthly, quarterly, half-yearly or annually. The returns are submitted to APRA via the Direct to APRA (D2A) software that it provides. D2A enables entities to electronically connect with APRA to download, complete and submit returns securely.

APRA receives data through D2A from over 6,000 reporting institutions. Every year, APRA receives about 27,600 returns containing over 150,000 different reporting forms.² These figures include data from the APRA-regulated industries as well as reporting institutions such as RFCs, medical defence organisations, general insurance intermediaries, discretionary mutual funds and wholesale funders.³

Prudential supervision

APRA supervisors and risk specialists use the data collections to assist in the supervision of regulated institutions. Two of the primary uses of the data are for off-site analysis and industry analysis.

Off-site analysis

Off-site analysis refers to analysis by supervisors and other areas of APRA that is not part of a prudential review of a regulated institution. It includes the analysis of each regulated institution's data as well as other information, either required (such as audit reports and financial condition reports) or requested by the supervisor.

In analysing the data submitted, and perhaps other sources of company data, supervisors examine trends and anomalies in areas such as financial strength and operations. Ultimately the supervisor's aim is to form a forward-looking, holistic view of the institution having considered the key risks, emerging trends, financial data and market environment. The assessment reflects the key risks associated with the regulated institution.

To support effective supervision, it is critical that the data supplied by regulated institutions are accurate and on time. Apart from affecting the reliability of a supervisor's analysis, errors in the data may indicate that there are areas that require more supervisory attention.

² This does not include resubmissions. Paper returns may be accepted in some instances.

³ General insurance intermediaries and wholesale funders are not collected under FSCOD.

APRA's DATA COLLECTIONS

Errors or changes to a regulated institution's calculations and assumptions can introduce inconsistencies between data from different periods. Without sufficient supplementary explanation, changes in the data between periods may mislead supervisors if they are interpreted as a trend or signal. If errors are identified after submission due dates, the regulated institution is expected to advise APRA without delay and agree on rectification measures.

It is not only the actual financial data submitted that may indicate that a regulated institution's risk management practices or operations require further scrutiny. Prudential reporting obligations under FSCOD are outlined in the reporting standards and due dates are known well. Each institution that submits data to APRA must ensure that its systems, processes and resulting outputs have been reviewed and tested to meet the requirements of APRA's reporting framework. It is the duty of the board and senior management to ensure that policies and procedures are in place for the authorisation and submission of accurate data to APRA.⁴

Where an institution repeatedly resubmits data due to errors or is providing inconsistent or poor responses to data queries, this signals to the supervisor that there are areas of risk that need to be investigated. Similarly, an institution that submits late data for an unexceptional reason (such as an unplanned staff absence) may signal that it has not ensured that its business units (or out-sourced service providers) understand the reporting requirements or have sufficiently resourced their regulatory reporting area.

Industry analysis

APRA conducts industry analysis of its regulated industries, including the effects of prevailing economic conditions. Data collected from individual regulated institutions are a key component of the analysis and research that APRA conducts at peer group or industry level.

The purpose of industry analysis is to assist APRA in identifying current and emerging issues that affect or may affect part or whole of an industry, and provide information that is used to compile a wide range of outputs, including policy development, APRA's risk registers, stress-testing of institutions and internal and external research papers.

⁴ This wording is contained in each reporting standard.

APRA works closely with institutions to achieve timely and high-quality submission of data because poor quality or missing data can impact upon a supervisor's ability to make accurate and timely judgments, which in turn influence supervisory stances. An error may also, of course, impact upon other users of the data.

Uses of APRA data by the RBA and ABS

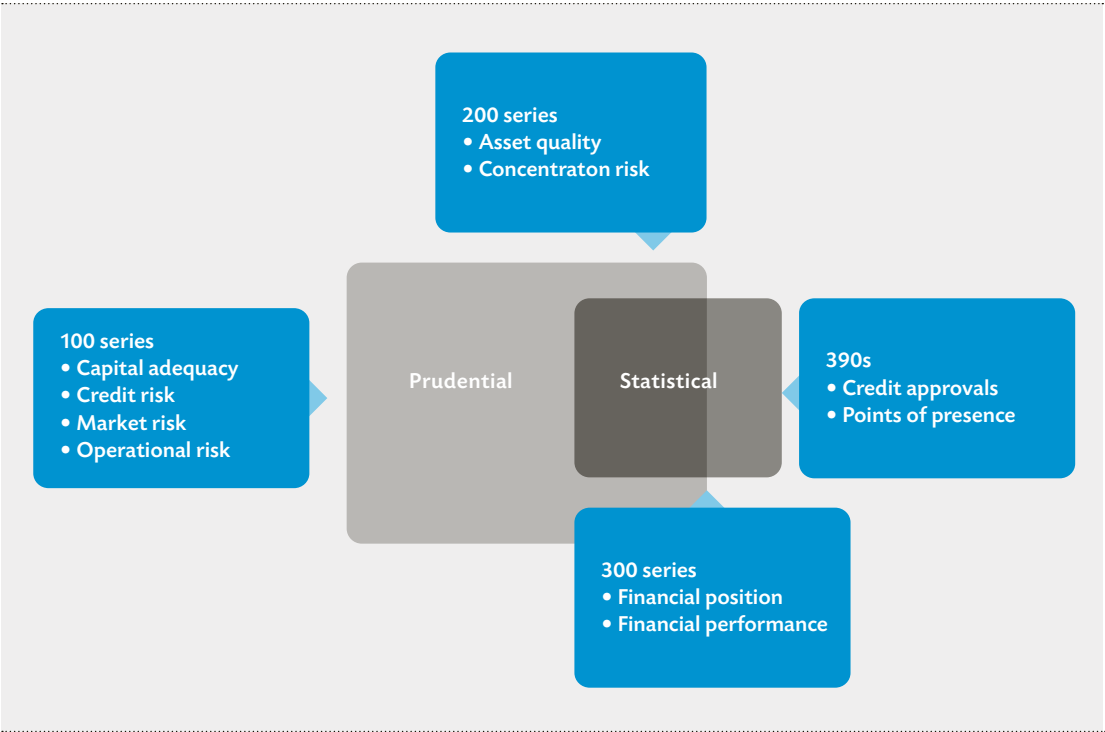
An obvious benefit from APRA performing the role of a central repository and collector of statistical data for the Australian financial system is that regulated and reporting institutions report the data via only one system (D2A). About 80 per cent of data collected by APRA are shared with the RBA and the ABS. Institutions only have to communicate with one agency, APRA, regarding data quality and follow-up questions from the three agencies. Requests for data and customised statistics (e.g. by other bodies such as Treasury and the International Monetary Fund (IMF)) are typically able to be fulfilled by APRA without the need for institutions to be asked again or directly contacted.

In the case of the RBA and the ABS, twice-daily electronic data feeds are sent from APRA. This means that there is very little lag between data submission and data sharing with the other agencies. Consequently, when an institution resubmits data due to an error or change in reporting, it is important that APRA be informed by the institution beforehand so that APRA can notify the RBA and the ABS that there is revised data that may affect them.

Figure 1 gives a simplified view of the data collection for authorised deposit-taking institutions (ADIs). The majority of APRA's reporting standards and returns enable the collection of financial statistics for prudential purposes such as capital adequacy, market risk and operational risk. The 100 series of ADI reporting forms, shown in Figure 1, are an example of data collected for prudential purposes. Other returns, such as the 200 and 300 series of ADI reporting forms, have a prudential purpose but are also of statistical interest. Some other returns are primarily for statistical purposes, including the 390 series of ADI reporting forms that including data on points of presence and credit approvals.

APRA’s DATA COLLECTIONS

Figure 1: Structure of the ADI data collection



The data submitted to APRA assist the RBA in monitoring and forecasting trends in the Australian economy and financial system and in providing regular advice on these trends to its Governors and Board.

Reserve Bank of Australia (RBA)

The RBA has three internal groups that are concerned with the data collected by APRA:

- Financial Markets Group (including Domestic Markets and International Departments) monitors developments in financial markets and coordinates the RBA's relationships with international institutions;
- Financial Stability Department (part of Financial System Group) monitors indicators of financial stability and develops policies to promote stability in the financial system; and
- Economic Group is responsible for analysis of economic trends, both in Australia and overseas, and for forecasts and research relevant to monetary policy.

The RBA uses APRA data as a key input in the execution of the various responsibilities outlined above. For example, Domestic Markets Department uses APRA data to help monitor the cost and availability of finance in the economy through examining a range of financial indicators such as credit, lending rates and bank funding costs, while Financial Stability Department uses APRA data to track developments in bank profitability, asset quality and capital adequacy. Consequently, the data submitted to APRA assist the RBA in monitoring and forecasting trends in the Australian economy and financial system and in providing regular advice on these trends to its Governors and Board. The data received from APRA also assist the RBA in contributing to the work of the Financial Stability Board and the Basel Committee on Banking Supervision (the RBA is a member alongside APRA). The RBA also uses the data collected by APRA as an input to its contributions to other bodies and to meet Australia's international reporting obligations.

APRA'S DATA COLLECTIONS

Using these statistics, the RBA publishes a range of research, commentary, statistics and reports on its website. These are used by a wide variety of users, including APRA-regulated institutions.

Australian Bureau of Statistics (ABS)

The ABS's role is to assist and encourage informed decision-making, research and discussion within governments and the community. The ABS provides statistics on a wide range of economic, industry, environment and energy, people and regional matters, covering government, business and the community in general. The ABS also has an important leadership and coordination function with respect to the statistical activities of other official bodies, both in Australia and overseas.

Data collected by APRA are a major component of a number of ABS economic statistics, including the Australian National Accounts. The National Accounts provide quarterly and annual data about the level of economic activity and the structure of the Australian and state economies within a coherent system of concepts and classifications. The main users of the accounts are Australian government agencies (in particular the Treasury), the RBA, State government agencies (in particular State treasuries), international organisations such as the IMF and the Organisation for Economic Cooperation and Development (OECD), economic analysts in the private sector, the media and academics.

National Accounts information is used to:

- formulate and assess government macroeconomic policies, both fiscal and monetary;
- assist in allocating Australian government funds to state governments;
- formulate industry development policies;
- undertake financial and business planning; and
- facilitate international economic comparisons.

The production of the National Accounts is one of the ABS' core work programs. It is also a complex task, involving the integration of data from many sources – e.g., statistical surveys of businesses and households and administrative data. Financial institutions, due to their role as financial intermediaries, provide important information on financial flows throughout the economy. The transactions of financial institutions reflect the liquidity, and current and capital expenditure, of other sectors. Data collected by APRA are vital for ensuring the accurate and timely measurement of the contribution of the financial services industry as the APRA-regulated and reporting populations form a significant portion of this industry, the largest in the Australian economy in 2010/11.

Economic analysts and policymakers not only require accurate and timely information on the movements in, and magnitude of, the principal national accounts aggregates but they must also have confidence that these indicators are fit for purpose.

An important aspect of the quality of National Accounts statistics is that the concepts, definitions and classifications should be relevant to, and understandable, by users. To this end, Australia's National Accounts are produced within an integrated statistical framework based on the international statistical standard, 2008 System of National Accounts. The application of international standards is essential to ensure that Australian economic statistics are coherent, comprehensive, reliable, relevant and comparable with the macroeconomic statistics of other nations. The statistics collected by APRA assist the ABS in applying the 2008 System of National Accounts standard.

The key publications that the ABS produces using data collected by APRA are:

- Australian System of National Accounts (cat. no. 5204.0) – issued annually;
- Australian National Accounts, Financial Accounts (cat. no. 5232.0) – issued quarterly;

- Australian National Accounts: National Income, Expenditure and Product (cat. no. 5206.0) – issued quarterly;
- Managed Funds, Australia (cat. no. 5655.0) – issued quarterly;
- Housing Finance, Australia (cat. no. 5609.0) – issued monthly; and
- Lending Finance, Australia (cat. no. 5671.0) – issued monthly.

APRA statistics

Publications

In line with the Government's expectations of a statistical agency for the financial system, APRA's aim in releasing publications is to promote:

- understanding and assist research, public discussion on policy issues and well-informed decision-making about the financial system by regulators, policymakers, industry and the public; and
- transparency and accountability of the financial institutions APRA regulates.

APRA'S DATA COLLECTIONS

As an independent source of statistics, all of APRA's statistical commentary is objective, impartial and non-editorial.

APRA publishes a number of regular statistical publications free of charge on its website. These include monthly, quarterly, half-yearly and annual publications. The publications are typically provided in two formats – Portable Document Format (PDF) and Microsoft Excel – for printing and analysis, respectively. Four of the publications are accompanied by databases of additional detailed and historical data to allow users to create their own reports.

In using the data to produce its statistical publications, APRA follows international standards and adheres to the following principles:

- **Impartiality.** APRA's statistical publications present data in a balanced manner without bias. As an independent source of statistics, all of APRA's statistical commentary is objective, impartial and non-editorial.
- **Transparency.** The statistics that APRA publishes contribute to the transparency of the financial system – e.g. through providing unit-level data and complete industry statistics.
- **Confidentiality.** APRA protects the confidentiality of commercially sensitive or private information provided by institutions. APRA is mindful of both the potential for released statistics to affect financial stability and of the commercial sensitivity of institutions' data. To ensure it has appropriate regard to confidentiality and protects privacy in its statistical publications, APRA:
 - consults with industry when determining which data are non-confidential under s.57 of the *Australian Prudential Regulation Authority Act 1998*;
 - has regard to commercial sensitivity identified during consultation with industry;
 - follows policies to protect the confidentiality of all other institutional information; and
 - maintains the privacy of individuals and individuals' information in published data.

A constant challenge for APRA is to meet the above principles and adapt to the needs of users.

Regulated and reporting institutions submit data to APRA at defined periods following the reference date for the data (for example, 20 business days after 30 June). For many of the annual reporting requirements, the data must be audited and the submission date is up to four months after the reference date. The lag in receiving data means that the production of an APRA publication starts as soon as APRA receives the data. APRA reviews the data and any trends and anomalies identified. APRA requires institutions to explain errors or reclassifications that could form the basis of any footnotes to publications (including those produced by APRA, RBA and the ABS). This will ensure that users understand the reasons for relevant movements in the data, which may require the name of the institution involved to be disclosed.

A common theme of the feedback APRA receives on its statistical publications is the desire of users to receive the data earlier. In 2010/11, APRA brought forward the release dates of four of its publications.

Customised statistics

APRA compiles customised statistics to fulfil requests for information from its data collections that is not regularly published. Requests come from:

- APRA senior management;
- the RBA and ABS (for data not included in their regular data feeds);
- Treasury and other government agencies to assist in the provision of advice and policy formulation;
- international agencies such as the IMF, the OECD and the Bank for International Settlements (BIS), for inclusion in international statistics that facilitate comparisons of various aspects of the Australian financial system with those of other countries; and
- academics and researchers.

APRA's statistics unit fulfilled over 200 requests for customised statistics over 2010/11.

APRA's DATA COLLECTIONS

Improvements and changes to APRA's data collections

Users of APRA's data rely on the provision of high-quality and timely data from institutions, which in turn places a sometimes significant but necessary cost upon these institutions. In an effort to reduce reporting burdens and cost, APRA has implemented, or is in the process of implementing, a range of improvements to the collection of data. This includes improvements to D2A and APRA's commitment to the Standard Business Reporting initiative.

Data validations in D2A

APRA ensures that the data collected passes 'mandatory' validation rules (rules that an entity must pass to correctly complete the reporting forms) and that institutions adequately explain anomalies identified by 'confirmation' validation rules. The mandatory and confirmation rules are determined through consultation within APRA (and often with the RBA and ABS). The validation rules are reviewed and tested by APRA to ensure that they identify errors and anomalies.

In November 2010, APRA upgraded D2A to include most validation rules within D2A. This change enables institutions that submit data directly to find and fix errors in their information and explain data anomalies, as part of their initial submission to APRA. This improvement saves institutions time and effort as they no longer have to respond to as many post-submission validations from APRA. In September 2010 (before the changes to D2A), APRA sent 2,250 post-submission validations to institutions; in December 2011, that number was 510. There has also been a reduction of the frequency of submission of erroneous data to APRA. Data users now benefit from the data being 'fit for purpose' at or soon after the due date.

Standard Business Reporting

APRA is a member of the Australian Government's Standard Business Reporting (SBR) initiative that simplifies business-to-government reporting. APRA's work on clarifying and describing each data item collected through D2A has enabled the production of an SBR taxonomy that now harmonises all D2A reporting with the business reporting to other participating Government agencies (Australian Taxation Office, the Australian Securities and Investments Commission and State and Territory revenue offices).

The SBR taxonomy contains a clear description of each data item collected through D2A and clarification of the requirements is available on APRA's website in APRA's Plain English Taxonomy (PET).

The SBR taxonomies have been written in the eXtensible Business Reporting Language (XBRL). XBRL is used for financial reporting in an increasing number of countries around the world. APRA has released an upgraded version of D2A that accepts data in the most recent version of XBRL. This release of D2A (version 5.1) has:

- the ability to import XBRL 2.1 report/forms into D2A; and
- an XBRL 2.1 report/form generator, which generates sample reports/forms from data already in D2A.

At the request of some institutions, APRA has added a test mode to the new version of D2A. In test mode, D2A is able to perform many functions, such as downloading returns, forms and validation rules and testing XBRL 2.1 imports without the risk of accidentally submitting to APRA.

APRA will also release a new version of D2A in 2012 that includes the use of a single secure sign-on (referred to as an 'AUSkey') that allows entities to submit reports to all SBR-participating Government agencies.

Conclusion

APRA's data collections ultimately contribute to a more stable, competitive and efficient financial system. On an institution level, they are a vital input into supervisory actions. On a macroeconomic level, they are used by many decision-makers in the Australian financial system, including policymakers, other regulators, senior management of financial institutions, market analysts and researchers.

Incorrect or inconsistent data submitted to APRA may have a significant impact on the reliability and accuracy of data immediately available to APRA, the RBA and the ABS. For users of APRA's publications and customised statistics, poor data affects timeliness because remediated data or supplementary information must be obtained. Hence, it is essential that regulated and reporting institutions submit relevant, timely and accurate data to APRA, and the great majority of institutions do so.

APRA will continue to collect data to the highest standards so that the information it publishes is deservedly trusted and timely.

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Data Collection