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Confidential Communication

General Manager
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Australian Custodial Services Association response on Topic Paper 2 - Performance

Dear Sir/Madam

The Australian Custodial Services Association (ACSA) is the peak industry body representing members of Australia's custodial and investment administration sector. Our mission is to promote efficiency and international best practice for members, our clients and the market.

Collectively, the members of ACSA hold securities and investments in excess of AUD $3 trillion in value in custody and under administration. Members of ACSA include NAB Asset Servicing, J.P. Morgan, HSBC, State Street, RBC Investor & Treasury Services, BNP Paribas Securities Services, Citi and Northern Trust.

While members of ACSA are not the subject of the regulation, many ACSA members are currently engaged by RSE's to assist in meeting their regulatory reporting obligations. This will typically utilise the accounting and valuation records maintained by the custodian (as investment administrator) for the fund. Accordingly, it is expected that ACSA members will continue to play a significant role in collecting and collating performance information, fees and costs data to support clients' data needs including APRA reporting requirements.

ACSA welcomes engagement with APRA on the enhancement of comparability and consistency of reported data. The over-riding principles should be that the data is fit for purpose, practicable to produce, based on standard data and calculation definitions, and be harmonised across regulatory agencies (in terms of data dictionary and reporting timelines).

Please note that the views expressed in this letter are prepared by ACSA for the purposes of consideration by APRA in response to Topic Paper 2 (Performance) of the Superannuation Data Transformation project and should not be relied upon for any other purpose. The comments in this letter do not comprise financial, legal or taxation advice and should not be regarded as the views of any particular member of ACSA.

EXECUTIVE SUMMARY

Our detailed response to the Topic Paper can be found in Attachment 1. Key points include:

- To promote industry consistency in application and efficiency, consider adopting a uniform approach in calculating net investment return by aligning SRS 705.1 and SRS 700.0;
- It is recommended that the new ASIC RG 97 reporting requirements be implemented to these APRA returns from 1 October 2020 to provide RSEs and their service providers adequate time to implement the change in a controlled and cost-effective manner;
- Ensure alignment with the new RG 97 framework, including definitions such as inter-posed vehicles and the platform test; and
- Limitations in the proposed methodology for calculation of option return volatility such as using historical data sets to predict future performance, using weekly returns as the period of time as some funds are revalued at different intervals and collecting data as far back as 10 years is likely to create implementation challenges and/or historic data that is no longer reliable as an indicator of future performance.

CONTACT INFORMATION

We welcome further dialogue with representatives on the views of ASCA and thank you for your consideration to date.

If you have any questions in relation to this letter, please direct those questions to the Deputy Chair the ACSA Regulatory Affairs Working Group, [redacted].

Yours sincerely

[redacted]

[redacted]
Chair
Australian Custodial Services Association

About ACSA

www.acsa.com.au

Custodians provide a range of institutional services, with clients typically favouring a bundled approach to custody and investment administration. Solutions may include traditional custody and safekeeping, investment administration, foreign exchange, securities lending, tax and financial reporting, investment analytics (risk, compliance and performance reporting), investment operations middle office outsourcing and ancillary banking services.

These services represent key investment back office functions – often representing the client's asset book of record and essential source data in relation to the investments they hold.

The key sectors supported by ACSA members include large superannuation funds and investment managers, as well as other domestic and international institutions.

ACSA works with peer associations, regulators and other market participants on a pre-competitive basis to encourage standards, promote consistency, market reform and operating efficiency.

Attachment 1 ACSA Responses

Question	ACSA Response
1. APRA seeks feedback on the collection of return objectives as set out in this Topic Paper and associated reporting standards and any barriers to providing the information, for example, whether particular RSE licensees could not report in the format proposed.	ACSA is supportive of the aim to provide members with improved information to assist in their decision-making and improving the quality of disclosure. However, ACSA notes that providing information in line with the proposed format could pose challenges to the industry in terms of consistency. Specifically, this relates to the calculation of net investment returns and net returns as the current proposals do not provide adequate prescription to ensure industry consistency in their application. By way of example, it is noted that the net investment return of MySuper products, APRA proposed that the calculation to be "…. net of indirect costs, other fees and costs, fees deducted directly from member account and tax with a component activity type of investment or transaction, adjusted for cash flows as they occur", however, this appears to differ from the SRS 700.0 (Product Dashboard) definition. This has the potential to lead to inconsistent reporting and impede comparability. In addition, it will not comply with the proposed operation of section 29QC of the Superannuation Industry (Supervision) Act 1993[1]. Included below are the definitions of net investment return within SRS 700.0 & SRS 705.0, which highlights the differences in methodologies between the two forms: **<u>SRS 705.0:</u>** **Net investment return** – Means the time-weighted rate of return on investments, net of **indirect costs**, **other fees and costs, fees deducted directly from member account** and **tax** with a **component activity type** of **investment** or **transaction**, adjusted for cash flows as they occur.

[1] Section 29QC: if an RSE licensee provides information that APRA requires to be calculated in a particular way under a reporting standard made under the Financial Sector (Collection of Data) Act 2001, and the licensee gives the same or equivalent information to another person, including on a website, the licensee must ensure that this information is calculated in the same way as the information given to APRA.

Question	ACSA Response
	<u>SRS 700.0:</u> **Net investment return** – Represents the time-weighted rate of return on investments, net of investment fees, indirect cost ratio investment costs, other investment costs and taxes on investment income, adjusted for cash flows as they occur. The new reporting standards aims to align with the RG97 framework. As outlined in our response to question 2, this information can potentially be required earlier than for RG 97 reporting purposes. Consequently, obtaining the necessary look-through information earlier, can result in significant effort and cost, which will ultimately be borne by the members. In addition, providing this information on a quarterly basis as per APRA's proposal can make comparability and analysis across products and funds challenging. For example, some fees and costs are charged/incurred on an annual basis, such as tax and management fees. Furthermore, some investments can be seasonal; for example, Australian investments might perform better in certain quarters than overseas investments due to differences in seasons and differences in financial years (30 June versus 31 December). ACSA suggests for the reporting frequency to be on a less frequent basis such as half-yearly or annually.
2. Through SRS 705.0, APRA is proposing the collection of data that is aligned with updated RG 97 requirements from 1 July 2020, which is ahead of ASIC's revised disclosure requirements coming into effect on 30 September 2020. APRA seeks feedback on the proposal for RSE licensees to provide this data to APRA from 1 July 2020, rather than reporting	ACSA supports APRAs objective for consistent reporting and disclosure of fees and costs APRA reporting standards and ASIC Regulatory Guide 97. Changes to RG 97 were announced in November 2019 with the first implementation date of 30 September 2020, that being for all PDS issued or after his date. Periodic statements or exit statements – on or after 1 July 2021 In order to support these changes outlined in the updated Regulatory Guide 97 released in November 2019, RSEs and their service providers have implemented project teams working to the deadline for new or updated PDSs from 30 September 2020. For those RSEs impacted by the 30 September 2020 deadline, streams of work, would currently be in place to meet this deadline.

Question	ACSA Response
one quarter under the current classifications.	Introducing a new deadline for these ahead of the RG 97 schedule will require the project teams to deliver to an earlier deadline than expected and will place significant pressure on both the time/resources to deploy and the cost of implementation to deliver the required information in a shorter timeframe for these returns. It is recommended that the RG 97 reporting requirements announced in November 2019 be implemented to these APRA returns from 1 October 2020 to provide RSEs and their service provider's adequate time to implement the change in a controlled and cost-effective manner. This timeframe will also provide RSEs who issue new or updated PDSs post 30 September 2020 and who are working to a different timeline (e.g. December 2020) sufficient time to implement the RG 97 changes into the APRA returns ahead of their PDS deadlines. It is important to note that the period of reporting within PDSs will/may not always be aligned to the reporting periods of the APRA returns.
3. APRA seeks feedback on any instances where reporting of indirect cost under RG 97 would not capture costs which are captured under the look-through provisions at subsection 13(4A) of FSCODA. Additionally, APRA seeks feedback on any platforms, products, investment menus or investment options that would not be able to report fees and costs under SRS 705.0 due to the application of the Platform Test in RG 97.	The indirect costs to be reported under RG97 are critically dependent on the concept of interposed vehicles. The concept of interposed vehicles effectively dictates the look through requirements of RG97 and therefore the inclusion of indirect costs within fees and costs reporting. The definition of an interposed vehicle found at para RG97.303, states: As shown in Appendix 1 (Figure 16), an interposed vehicle is a 'body, partnership or trust' that: a) is not a platform under the 'platform test' (see RG 97.308-RG 97.309); and b) meets either: (i) an 'assets test' (see RG 97.311-RG97.316); or (ii) a 'PDS test' (see RG 97.317-RG.324). The provision of documents and information to APRA under subsection 13 (4A) of FSCODA has a broad definition of 'relevant assets' and therefore potentially could capture indirect costs beyond those required

Question	ACSA Response
	to be reported under RG97. For example, under the RG97 interposed vehicle definition it is likely to result in infrastructure assets/entities being excluded and therefore the indirect costs associated with that infrastructure asset/entity not being required to be reported on under RG97. Whereas, the same infrastructure asset/entity may be considered a relevant asset under subsection 13 (4A) of FSCODA and therefore require the reporting of costs associated with that infrastructure asset/entity on a look through basis. Additionally, regarding the platform test in RG97, there is a definition that clearly describes the determination if the entity is a 'platform' for the purposes of being excluded from the definition of an interposed vehicle (see RG 97.308-RG 97.309). While members of the Australian Custodial Services Association are not responsible for determining if an entity is a 'platform' and excluded from the definition of an interposed entity, we do encourage simplification and harmonisation of the regulations.
4. APRA seeks feedback on the proposed methodology for the calculation of option return volatility item in Table 3 of SRS 705.1.	In relation to the APRA proposal to collect a measure of the standard deviation of weekly option returns for the five-year and ten-year periods ending each quarter, ACSA interpreted that the annualised standard deviation using weekly returns data is required. Annualised standard deviation = Standard deviation of weekly returns * Square root (52) ACSA welcomes the intended objective of this proposal to enable comparability of investment options performance across the industry. However, ACSA recognises the following limitations of applying volatility and questions around the required data sets: a) Volatility looks backward, it is the annualised standard deviation of historical returns which may not be accurate prediction of future performance; b) There are other economic factors that may affect volatility;

Question	ACSA Response
	c) Standard deviation changes in proportion to the period of time, weekly returns may not be the appropriate period or the right measurements; d) By collecting data as far as 10 years, there may be irrelevant data for the future, ACSA recommended a shorter period to be collected; e) ACSA acknowledges that the RSEs would have historical returns data but may not meet the required methodology as required by APRA, there will be costs and efforts to implement; and f) In terms of disclosure, the technical definition of volatility may not be what members think of as "volatile" – say, the possibility of capital loss. It is a difficult concept to interpret without context and education (and, at the end of the day, only one measure of risk).
5. APRA seeks feedback on whether the calculation of long term returns based from quarterly data could result in a materially different return from RSE licensees' own return calculations, and if so, reasons for the difference?	There should be no difference if the methodology is standardised (agreed mathematical formula and data elements). A common mismatch can occur if one party provides a geometric (chain linked) time series calculation and another simply adds individual quarterly returns. Conceptually, this is similar to the difference between simple versus compound interest calculation ACSA suggests that this point may be better explored through industry performance measurement practitioners and worked examples.
6. APRA seeks specific feedback on any barriers to providing the 10 years of historical data (as noted in Chapter 3 above) to be submitted on the first collection of SRS 705.1.	Although many institutions may have this historical data, there may be gaps or complexity in tracking down/verifying specific return elements, in particular individual fee components to arrive at the net/gross returns. It may also be possible that the historical return calculation differs from what APRA is requesting in SRS 705.

Question	ACSA Response
7. Feedback as outlined in item 5.1 "Feedback sought on confidentiality proposals".	ACSA does not have a view as to whether any information collected under SRS 705.0 and SRS 705.1 should remain confidential or not – this is matter for the directly regulated entities (RSEs), and other legislation (including privacy).

Appendix 1

Figure 16: Definition of an interposed vehicle

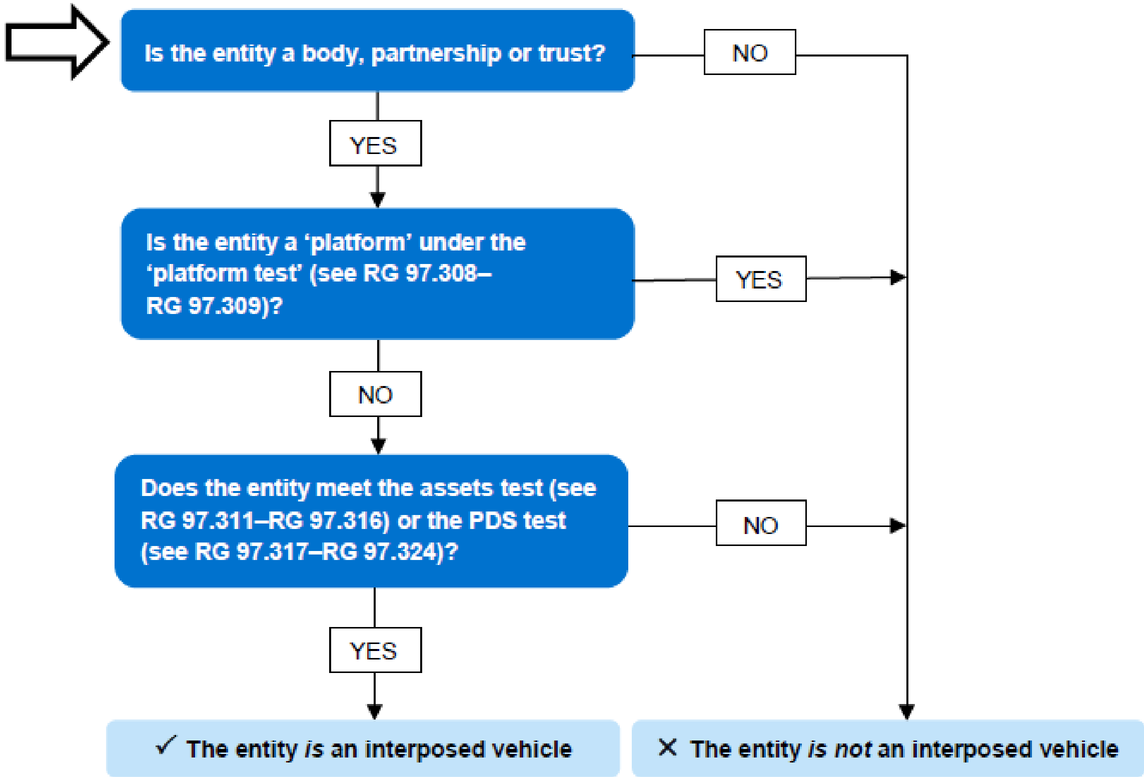

Figure 17: Determining whether a product is invested in or through an entity