CareSuper

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Dear Sir or Madam

CareSuper submission – APRA consultation draft Reporting Standard (SRS) 332.0 Expenses

Thank-you for the opportunity to provide a submission in relation to Topic Paper 4 on draft "Reporting Standard SRS 332.0 Expenses" (SRS 332.0).

CareSuper fully supports the aim of draft SRS 332.0 to gain deeper insights on expenses incurred through additional granularity and consistency of expense reporting at the RSE licensee and RSE level. CareSuper's objective is to support these goals though the feedback provided as part of this submission.

Overall Comments

With respect to the proposed SRS 332.0, CareSuper considers that there are several overall concerns that should be raised which may have unintended consequences for members as well as overall concerns regarding the practical application of the new reporting requirements.

While these concerns have been outlined in more detail in our responses to the Consultation Questions, they have been summarised as follows:

CONFIDENTIALITY

CareSuper is concerned that the publication of these costs, particularly with the disclosure of the identity of different providers, will result in a reduction in competition and not be in members' best interests.

Negotiations with administrators, custodians and investment managers must be able to continue on a confidential basis in order for a superannuation fund to be able to achieve competitive terms with these service providers on a commercial basis.

It is this ability to negotiate terms on a confidential basis that provides funds with the competitive advantages that are possible through scale as well as through commercial considerations such service providers' appetite for new business. Prior knowledge of the costs charged by current incumbent providers will significantly impair the ability of funds to conduct tenders and negotiate fees in a competitive environment. In addition, knowledge of a service provider's competitor's fees basis will disadvantage funds who seek to renegotiate fees after an initial fee guarantee period as it provides service providers with the capacity to maximise their margins and still be competitive.

In addition, while RSEs can provide APRA with this information, its public release will be in contravention of mutual confidentiality clauses in supplier contracts.

ALIGNMENT TO FINANCIAL STATEMENTS

CareSuper notes that APRA's comments in Topic paper 4 (paragraph 2.3) that:

> *"APRA proposes that the total expenses reported be aligned to, and be able to be reconciled with, the expenses reported in the financial statements. This will enable a complete picture of how members' money is being spent by RSE licensees and for these expenses to be appropriately understood and benchmarked."*

It is noted that the financial statements of superannuation funds do not include expenses for investment management fees that are incurred within pooled investment vehicles. As such, the proposed reporting

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standard does not present a level playing field for funds. Funds which invest mostly through pooled vehicles will report lower, and potentially zero, investment management expenses.

It is also noted that where funds insource their investment management, there will be a misalignment between what is reported in a fund's financial statements and the expense data which is collected through proposed SRS 332.0. As the costs of in-house investment management are not explicit, there will be issues in relation to the comparability of the data.

It is therefore inequitable that funds which invest to a greater extent through individual accounts and for whom the costs are explicit will be held to a greater level of scrutiny of investment expenses. Investment management expenses are ultimately captured in aggregate through the proposed Fees and Costs reporting standard.

FAIRNESS ACROSS BUSINESS MODELS

It is noted that one of APRA's objectives is to improve comparability and consistency. Our comments outlined above in relation to the inconsistent treatment of funds which outsource or insource administration or invest to a greater extent through individual accounts are also relevant in relation to the treatment of funds with different business models.

Consistency will not be achieved due to the potential for advantage or disadvantage depending on a fund's particular business model:

- retail versus industry,
- outsourced models versus vertically integrated or internally delivered.

CareSuper believes that no particular business model should be favoured as this has the potential to motivate business decisions and also reduce the reliability and comparability of the data for both members and APRA.

POTENTIAL GAMING

It should be noted that not all funds allocate costs in the same way e.g. the allocation of data analytics costs or administrator support to marketing costs. In addition, costs may be allocated to the Trustee company rather than the RSE. While the aim of draft SRS 332.0 is to provide this consistency, it is unlikely that this will occur without a longer consultation process with funds and administrators. This inconsistency in approach may have implications for funds being able to "game" the reporting process.

While CareSuper is supportive of the increased disclosure in the area of expenses, we would propose that APRA reduce the granularity of the data in order than there can be more consistency in the data provided by both funds and administrators and to also reduce the potential for gaming.

Detailed Feedback

Our feedback is provided in line with the relevant Consultation questions: Expense Reporting as detailed in Question 5 of APRA's Topic paper:

Consultation Question 1: What difficulties, if any, may arise in providing the expense reporting that relate to your specific operating model? Please provide information on these, and possible solutions.

PROVISION OF FEES CHARGED BY THE ADMINISTRATOR ON A DISAGGREGATED BASIS

CareSuper notes that the draft SRS 332.0 requires the reporting of administration costs on a disaggregated basis. Administration fees are currently charged by the outsourced administrator on a dollar cost per member per week basis. This is common practice by outsourced administration providers. All services provided by the administrator are included in this price as negotiated at the time of appointment. It is possible that the allocation of some expenses would be reported at a zero cost if they have been included as part of a tender negotiation.

The disaggregated information is not currently available and would require a significant engagement process with the administrator in order to be able to report to APRA. It is also likely that administrators will be resistant to the disaggregation of fees as it will disclose commercially sensitive information regarding the relative margins and cost structures across their service model. The disclosure of commercially sensitive information will also have implications regarding competition within the superannuation administration market and may have an unintended consequence of increasing prices and ultimately fees charged to members.

The granularity of the data and process of requiring administrators is disaggregate in order to provide this granularity would require assumptions to be made regarding staff and services who carry out more than one function. The need to make these assumptions, exacerbated by the limited timeframe available for funds and administrators to disaggregate their expenses structures, will result in significant inconsistency in the data reported. This allocation of expenses on an inconsistent basis by different administrators will make fund to fund comparisons less meaningful and may lead to "gaming" of the system.

Proposed Change:

While CareSuper is supportive of the increased disclosure in the area of expenses, we would propose that APRA reduce the granularity of the data in order than there can be more consistency in the data provided by both funds and administrators.

CHANGES TO ACCOUNTING SYSTEMS NECESSARY TO CAPTURE COSTS ON A PROSPECTIVE BASIS

The reporting of costs with the granularity required under draft SRS 332.0 would necessitate substantial changes to accounting systems in order that these costs can be captured on a prospective basis. These changes are likely to require a minimum of 18 months to complete to a standard that would not only ensure accuracy of the reporting but also not compromise other reporting requirements such as preparation of financial statements. Regardless of the fact that reporting would only be required on a prospective basis, figures from the prior financial year would also need to be amended on the accounting system to allow for year on year comparisons to be made.

The changes to accounting systems by the administrator would incur substantial costs to CareSuper and it is important that these changes are implemented in a planned and measured process so that such costs can be controlled. Trustee office staff would also need sufficient training in order to apply revised expense codes on a consistent basis.

The categorisation of expenses for APRA reporting would need to be reconciled back to the categorisation of expenses for financial reporting. Any inconsistency in the approaches would result in the need for parallel systems that would result in costly duplication in accounting processes.

ALLOCATION OF COSTS IN THE CURRENT FINANCIAL YEAR TO DATE

CareSuper notes that the first reporting period relates to the period to 30 June 2021. However, for the current financial year to date, systems have not been configured accordingly so these costs have not been captured in a form that would easily satisfy the reporting required for draft SRS 332.0.

As a result, there would need to be significant manual work in order to reallocate costs on a retrospective basis and would result in CareSuper incurring a substantial cost in order to secure these additional resources.

ALLOCATION OF COSTS ON A CONSISTENT BASIS ACROSS SUPERANNUATION FUNDS

It should be noted that not all funds allocate costs in the same way e.g. the allocation of data analytics costs or administrator support to marketing costs. In addition, costs may be allocated to the Trustee company rather than the RSE. While the aim of draft SRS 332.0 is to provide this consistency, it is unlikely that this will occur without a longer consultation process with funds and administrators. This inconsistency in approach may have implications with funds being able to "game" the reporting process.

MATERIALITY CONSIDERATIONS

It is noted that draft SRS 332.0 defines a materiality threshold that is consistent with SPS 515. However, the materiality threshold in SPS 515 is a risk-based assessment and not an expense-based assessment. A materiality threshold which is specifically expense based would assist funds to avoid reporting inconsequential amounts. In addition, the need to provide ABN and Name where expenses are trivial and where they are captured on credit card statements would be avoided if a materiality threshold is introduced. The need to find ABN details for these trivial amounts would require significant fund resources and costs.

Current tax invoice requirements do not require ABN details for amounts less than $82.50 and again this inconsistency would create difficulties where there is no materiality threshold.

LOOK-THROUGH DISCLOSURES FOR RELATED PARTY INVESTMENT MANAGEMENT ENTITIES

The Insourced and Related Party Payments section of expense reporting requires detailed disclosure requirements for the underlying expenditure of related party investment management entities.

CareSuper does not have access to the internal expenditure information of related party asset managers and it is not currently practicable for the fund to disclose information not under its control and to which there is no access or visibility. Provision, and public disclosure, of this detailed level of information is likely to be commercially damaging, as detailed below.

Proposed change:

While CareSuper acknowledges the need for funds to provide greater transparency regarding the costs they incur, we propose that:

- the date of implementation be delayed for funds to establish reliable accounting systems and also engage with administrators and other service providers in order that costs be disaggregated;
- further consultation occurs in order that funds and administrators have a consistent approach to reporting expenses to avoid "gaming";
- specific expenditure-based materiality thresholds be introduced to avoid the reporting of inconsequential amounts; and
- funds not be required to provide detailed disclosure requirements for the underlying expenditure of related party investment management entities.

Consultation Question 2 - Are there other 'expense groups' or 'expense types' that should be considered to be collected by APRA for expense reporting?

It is noted that installation/transition costs are not part of the APRA expenses reporting and while they would fall under "other", they represent a substantial cost in the transition to a new service provider. These costs are typically incurred over a number of years and would result in the on-going costs being inflated.

Consultation Question 4 - Feedback is sought on the expense reporting definitions, and suggestions to improve consistency in reporting on these.

As outlined above individual funds do not capture and define costs on a consistent basis including the allocation of indirect costs. We would propose that there be further consultation to define more clearly the requirements for reporting of individual items to ensure consistency in reporting and comparison between funds.

Consultation Question 5 - Feedback as outlined in item 4.1 Feedback sought on confidentiality proposals. Please ensure feedback is specific on which data items should remain confidential and any detriment to member or commercial interests.

As outlined in our overall comments, CareSuper is concerned that the publication of costs for outsourced services by provider, whether for investments management, administration, marketing and distribution or other services will be damaging for the commercial interests of the fund, be likely to result in a reduction in competition, potentially reduce investment return and incentivise investment actions that would otherwise not be taken, all of which would not be in members' best interests.

Our specific comments relate to three main areas of concern:

- Disclosure of commercial terms with other service providers such as administrators, asset consultants or custodians
- Disclosure of fee arrangements with individual investment managers
- Look-through disclosures for related parties

DISCLOSURE OF COMMERCIAL TERMS WITH OTHER SERVICE PROVIDERS SUCH AS ADMINISTRATORS, ASSET CONSULTANTS OR CUSTODIANS

1. **Concern**

   The disclosure of commercial terms would be prejudicial to all involved and could damage competition and the ability to secure the most competitive fee and potentially be detrimental to innovation, choice and competition in these various service industries. In addition, while RSEs can provide APRA with this information, its public release will be in contravention of mutual confidentiality clauses in supplier contracts.

2. **Detriment to members' or commercial interests**

   Administrators, Asset Consultants, Custodians and other Service Providers.

   As outlined in our response to Consultation Question 1, the disclosure of commercially sensitive information will also have implications regarding competition within the superannuation administration market. These implications also apply to services such as Asset Consulting and Custody as well as other service providers and may have an unintended consequence of increasing prices and ultimately fees charged to members.

   This prior knowledge of the incumbent's current fees and the nature of services provides is not conducive to funds being able to conduct tenders and negotiate fees in a competitive environment. In addition, knowledge of a service provider's competitor's fees basis will disadvantage funds who seek to renegotiate fees after an initial fee guarantee period as it provides service providers with the capacity to maximise their margins and still be competitive.

   Ultimately, these constraints on funds to negotiate fees is not in the best interests of members.

   Asset Consultants.

   Funds invest in research capabilities, skills and investment expertise in order to form views on investments and markets, that in turn prove profitable and return enhancing for members. This intellectual property is kept confidential across the industry as much of it is competitive in nature. It would be potentially detrimental for fund members to have other funds adopt, crowd or 'free ride' off this research.

   It is true that some asset allocation or positioning information is reasonably generic – such as basic SAA information. The disclosure of more detailed information that reveals actual positions or information that is competitive could be detrimental to members. Funds must be able to keep this for the benefit of their members.

   Often the ability to change an exposure or transact on a position is damaged by a market participant's knowledge of the existing position. If the market knows of an exposure, other actors in the market can 'game' your ability to trade the position. It is a well understood principle that market knowledge can, in some circumstances, directly compromise a financial outcome.

   The impact of market knowledge across a fund's investment program is likely to vary greatly. In some cases, it might not be harmful for members interests. In some instances, it is likely to compromise members interests, depending on exactly what is disclosed.

DISCLOSURE OF FEE ARRANGEMENTS WITH INVESTMENT MANAGERS

1. **Concern**

   The disclosure of commercial terms would be prejudicial to all involved. Commercial terms between funds and investment managers are usually explicitly confidential under contract and all our contracts stipulate strict confidentiality on fees. The sensitivity and importance of non-disclosure is evidenced by the fact that we often do not disclose commercial terms to our adviser. Every fee agreed with an investment manager is the result of detailed negotiation.

2. **Detriment to members' or commercial interests**

   Compromised fee outcomes.

   Our ability to secure the best fees for members relies on such fees and negotiations not being known to other parties. These parties not only include other funds, but also other competing investment managers. Fee outcomes could be significantly different should this occur. It is likely fees would become

more uniform between funds. We expect fees to our members would be higher as it would be more difficult to secure bespoke fee structures and the competitive tension between managers would be lost.

Amongst funds, there would be inadvertent winners and losers. We would expect our ability to secure lower fees for members would be inhibited on average. While it could be argued that disclosure of a fee by another manager could allow a fund to get a better deal with that manager, it is our assessment that the overall net impact is more likely to be negative for our members and also lead to unintended consequences.

Detriment to manager universe.

It could be more difficult for managers to commence operations and boutiques to start up, as foundation fees would become public knowledge. This may cause significant damage across the investment management industry. The competitive position between managers and the commercial interests of some managers would be compromised. We believe that our access to new, value adding managers at a low fee is likely to be diminished.

Impact on offshore managers with clients in other countries.

Offshore managers who are able to offer their capacity in other countries could be disincentivised to offer services in Australia as this would result in global disclosure of their fees. With Australia being a lower fee market, these fees are likely to be lower than they charge in other countries. This would be damaging to their global business. Accordingly, the better managers with more attractive capabilities may be less available to Australian funds.

A sought after manager could decide to offer access to non-Australian clients. The net result for members would be less access to high performing capabilities, less choice of investment and higher fees. A manager may, for example, be willing to take on an Australian client at a fee that is amongst the highest fees they charge. If this were the case disclosure of the fee would not damage their business interests.

We are not aware of any other jurisdiction globally where the disclosure of such terms occurs.

Disclosure of account size

In addition to the disclosure of fees, disclosure of portfolio size by individual account is also potentially damaging. Such disclosure would reveal detailed information about asset class construction and over time shifts in these allocations. Such disclosure may compromise the intellectual property of the fund and potentially reveal proprietary information.

Unintended consequences.

Additional unintended consequences could result – for example, manager fee disclosure could encourage funds to internalise investment capabilities in order to avoid disclosure. It would also unfairly favour funds with vertically integrated investment models. Distortion of decisions to internalise are possible – these decisions could be made for reasons that are not in members' interests and could very likely reduce net benefit.

Also, disclosure could accelerate the move to low quality, index or bulk investment capabilities.

3. In summary

Fees paid to investment managers are sensitive commercial terms and confidentiality is important for outcomes for members in the form of lower fees but also higher return. Disclosure would have a range of significant implications including:

- Potentially higher average fees, including reduced ability to negotiate, hindered ability to secure lower or one off deals or other special fee arrangements,
- Less innovation, choice and flexibility amongst investment capabilities,
- Potential damage to ability to access higher quality capabilities offered by global managers and/or this access being attached to high rack-rate fee that can no longer be negotiated, and
- Unfairly favour some business models over others, particularly internalised investment management capabilities.

LOOK-THROUGH DISCLOSURES FOR RELATED PARTIES

1. Concern

The Insourced and Related Party Payments section of expense reporting requires detailed disclosure requirements for the underlying expenditure of related party investment management entities. As outlined in our response to Consultation Question 1, the proposed disclosure with respect to the business activities of related parties is not considered practical or reasonable. However, we also have concerns in relation to the context of the proposed non-confidentiality of information disclosed.

2. Detriment to members' or commercial interests

Anti-competitive and commercially damaging.

Many investment management firms are privately owned, and therefore are not subject to public disclosure of expenses incurred through the operation of their business. It would be anti-competitive to require a super fund to provide a detailed breakdown of the expenditure of an investment management firm which is a related party, and through which the fund invests. Publication of this information creates a disadvantage to such investment management firms, as competitors which are not subject to this disclosure requirement will have unfair access to information about the expenses and profitability of the firm. This prior knowledge of incumbent providers, their current fees and the nature of services provides due to the publication of the information disclosed in columns 11, 12, 13 and 24 of Schedule 2 is not conducive to funds being able to negotiate the best terms for their members.

Potential detriment to an asset held by members.

This compromise to the competitive environment of a related party investment manager may impact the commerciality of the investment management business. As the investment management firm is held as an investment asset of the fund, an impact to its commercial viability would be experienced as a direct impact to return outcomes.

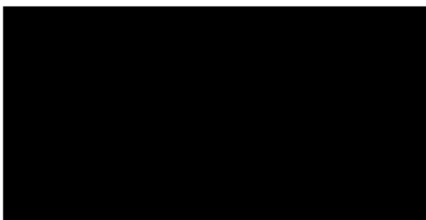
PROPOSED CHANGE – DATA ITEMS THAT SHOULD REMAIN CONFIDENTIAL

Due to the substantial concerns regarding the impact on the ability of funds to conduct tenders and negotiate fees in a competitive environment, CareSuper considers that the following disclosures remain confidential:

- Schedule 1 Expense reporting – Fees paid to outsourced providers particularly in relation to administrators; and
- Schedule 2 Investment management expenses - Fees paid to investment managers, asset consultants and custodians. Alternatively, if fees paid are published, the non-public disclosure of the information disclosed in columns 11, 12, 13 and 24.

Thank-you once again for the opportunity to provide this submission. If you have any questions, please do not hesitate to contact me on [redacted] We would also welcome the opportunity to meet with you to discuss this letter further.

Yours sincerely



Chief Risk Officer