Superannuation Data Transformation – Publications and Confidentiality

Executive Summary

Industry Super Australia (ISA) is a long-standing supporter of greater transparency in the super industry. We share APRA's view that greater transparency fosters more informed public discussion of super-related issues, promotes better practices through comparability and peer review, and drives accountability in the industry – all of which will ultimately benefit members.

On this basis, it is imperative that the movement to the new publications does not involve a significant loss of data or limit the ability to conduct sectoral analysis by fund type. Such an outcome would be a significant step backwards in the usefulness of the publications and runs counter to APRA's stated objective of improving transparency.

To maximise the usefulness of the publications and minimise the risk of commercial detriment to funds (where that detriment would not be in the interests of members), ISA makes the following key recommendations.

1. **New publications**: The movement to the new suite of publications should not involve a loss of data.

2. **Segmentation by fund type**: APRA should continue to publish data by fund type as it is critical to understanding the super landscape and member trends.

3. **Publishing data about strategic asset allocations**: APRA should ensure sufficient and up-to-date data about strategic asset allocations is published to allow users to estimate performance test results.

4. **Confidentiality concerns about expenses and derivatives**: APRA should consider not publishing certain data items relating to expenses and derivatives to reduce the risk of commercial detriment to funds. The publication of these data items could otherwise reduce a fund's bargaining power, which would result in higher costs being passed onto members.

Our submission also contains recommendations and suggestions relating to metrics, fees and costs arrangements, performance, and insurance.

Contents

About Industry Super Australia

Industry Super Australia (ISA) is a research and advocacy body for Industry SuperFunds. ISA manages collective projects on behalf of a number of industry super funds with the objective of maximising the retirement savings of nearly five million industry super members.

Industry Super Australia Pty Ltd, ABN 72 158 563 270, Corporate Authorised Representative No. 426006 of Industry Fund Services Ltd,
ABN 54 007 016 195, AFSL 232514.

Authors

[redacted]

Publication proposals

Overlap between new and existing publications

APRA seeks comments on a suite of new publications. These 'mock-up' publications have names that closely match a suite of existing publications, contain areas of overlapping data, but equally exclude huge volumes of critical data that is present in the current set of publications. Furthermore, these new publications are set to commence before the completion of Phase 2 consultations. It is unclear how APRA plans to reconcile the suite of new and current publications, or indeed the future of the current set of publications.

The volume of data that is missing from the current suite of publications is too exhaustive to detail. To provide some illustration of the level of concern:

1. Annual fund level publication

   The current fund level publication contains detailed, audited financial data on funds under management, fund cash flows, operating and investment expenses, and net returns. This data is critical to understanding a fund's relative performance and competitiveness and will be important in supporting marketing and advocacy expenditure under the Best Financial Interests Duty.

   In addition, whole of fund performance data is a meaningful and important measure of trustee performance and provides additional insights over and above product level returns. Fund trustees are responsible for fund level strategies which includes determining what products are offered to members, the features of each product (such as fees and asset allocation), and the terms of outsourcing arrangements. Fund level returns are also important in overcoming product complexity and choice overload, and in encouraging super funds to further compete on fees and investment returns. APRA's own research advocates the use of fund level returns to overcome some of the limitations of product level returns, see for example Sy and Liu (2009)[1]. In addition, both APRA and ISA research has shown that fund level and option level returns are strongly correlated.[2] Fund level performance data should be retained in the new publications.

   Furthermore, the current fund level publications contain a range of information on fund characteristics. Such information is important in understanding differences between funds and should be retained.

[1] Sy, W. and K. Liu, 2009, 'Investment performance ranking of superannuation firms', APRA Working Paper.
[2] See for example, APRA (2008), A Response to Review of APRA's Investment Performance Statistics of the Australian Superannuation Industry; and Gallagher, P. and Z. May, 2018, 'Are comparisons based on superannuation fund-level performance useful?', Industry Super Australia research paper.

2. <u>Quarterly aggregate publication</u>

Similarly, the current quarterly aggregate publication contains detailed data on financial and performance data and fund type. The new publication not only excludes this data but is substantially different in structure and has a limited time span of historical data.

It is imperative that any movement to the new publications does not involve the loss of significant quantities of data. Such a loss is counter to APRA's stated objective of promoting greater transparency which is critical to improving member outcomes and would significantly reduce the utility of current and existing data collections.

Recommendation: The movement to the new suite of publications should not involve a loss of data.

Segmentation by fund type

ISA considers there is significant value in industry segmentation as it enables consumers and other observers to identify funds based on common characteristics, and to allow comparison of funds with their peers and between sectors. The classifications recognise the differences that exist between funds, including governance model, profit orientation and ownership.

These differences are ultimately borne by members through fees and performance. The Productivity Commission's inquiry into the efficiency and competitiveness of the super system found significant differences in performance and fees between the for-profit and not-for-profit sectors.[3]

APRA has published aggregate statistics by fund type for more than 20 years.[4] This data has been used extensively over this period by government reviews, policy advisers, industry and academic researchers, and many others to better understand the super system. Ceasing to segment by fund type – especially if old publications are overtaken by, or merged with, new ones – will effectively orphan more than 20 years of sectoral performance data, and restrict future sectoral analysis of the super industry to a time period ending around 2021-22. Segmenting by fund type (and consistently including fund type as a variable at both the product and fund levels) enables valuable research, which ultimately promotes accountability and transparency in the super industry.

Reporting aggregate performance data by fund type and to a lesser extent at the fund level addresses common issues with product-level returns around selection bias and survivorship bias. In the case of selection bias, funds create new "track records" by investing small amounts of seed money. Those options with promising "track records" are then registered with the regulator to accept real client money while those that fail are quietly buried. Survivorship bias is related. In this case, poor-performing products are closed to new-entrants or rolled into new products, leaving only relatively good performers remaining. Basing long-term returns on surviving options at the product-level biases upwards the

[3] Productivity Commission (2018) 'Superannuation: Assessing Efficiency and Competitiveness', Productivity Commission Inquiry Report.
[4] See, for example, APRA (2007): 'Celebrating 10 years of superannuation data collection 1996-2006', APRA *Insight* Special Edition, Issue 2.

investment performance observed by members. Historically, this has been a particular problem for the retail and corporate sectors.[5] These issues have been canvassed extensively in the literature.[6]

While fund-type is to be retained in the new annual fund level publications, performance data is not. Even if it were, it is likely that confidentiality and privacy provisions would limit the availability of data from some smaller funds which would make aggregation of industry and sectoral performance difficult. In addition, such aggregations create an additional barrier that may limit insights to more sophisticated data users.

Segmenting data by fund type also provides insights into member demographics and preferences over time. These insights are increasingly relevant as members are encouraged to engage with their super, especially following the introduction of the performance test.

The suggestion that the current classifications of fund type are less distinct due to continued consolidations in the super industry is contested. Few mergers have occurred between funds of a different types, and for those that do, it is ultimately the fund type of the resulting entity that will dictate its ongoing business model. There is a clear difference in profit motive between the retail and not-for-profit sectors, but differences also exist between fund types within the not-for-profit sector, including public offer status, single versus multi-employer, and whether the fund had an employer sponsor who may have absorbed administration costs.

ISA therefore strongly disagrees with the proposal to cease segmenting data by fund type in the new publications. This would undermine the objectives set out in the discussion paper, namely, to foster more informed public discussion of super-related issues and promote better practices through comparability and peer review. The proposed changes are detrimental to consumer choice and transparency.

Recommendation: APRA's new publications should continue to segment data by fund type as it is critical to understanding the super landscape and member trends.

Segmentation by risk classification

While ISA supports segmentation of multi-sector investment options by composite asset class growth asset weighting there should be further consultation on the appropriate treatment of unlisted and alternative asset classes which can be defensive or growth oriented depending on the underlying assets. Further noting growth asset weighting is used to segment products by private super rating agencies, it is not a substitute for empirically based risk metrics including standard deviation of reported returns,

---

[5] The Productivity Commission estimated the extent of selection bias using SuperRatings data, and found that corporate funds had the worst coverage, followed by retail funds. Industry funds were estimated to have the best coverage, followed by public sector funds.

[6] See, for example, Productivity Commission (2018) 'Superannuation: Assessing Efficiency and Competitiveness', Productivity Commission Inquiry Report; Sy, W. and K. Liu, 2009, 'Investment performance ranking of superannuation firms', APRA Working Paper; and Rekenthaler, J., (2003), 'When mutual funds die companies bury their mistakes, distorting returns, Money Magazine, April 1, 2003.

Sharpe ratio and Risk Adjusted Value Add.[7] Ideally the growth asset ratio as well as empirically observed risk metrics should be published.

However, the categories provided in the discussion paper (0-40 per cent; 40-60 per cent; 60-75 per cent; 75-90 per cent; and 90-100 per cent) are imbalanced. Products with a weighting between 0 and 40 per cent are grouped into one category while on the other end of the distribution, those between 60 and 100 per cent span three categories. We note that SuperRatings categorises 0-19 per cent as Secure and 20-40 per cent as Capital Stable and Chant West similarly includes categories at 0-20 per cent and 21-40. We recommend that APRA split the 0-40 per cent category similarly.

Recommendation: APRA should consult further on growth asset ratios for unlisted and alternative assets and publish empirically based metrics to complement and validate categorisations. APRA should also reconsider the ranges used to segment the options to ensure the categories are balanced.

Publication of strategic asset allocation data

The publication of more detailed strategic asset allocation data will provide better insights into funds' investment strategies at the product level and overall positions at the fund and aggregate levels.

This is particularly important in the context of the performance tests, which use benchmark asset allocation data to construct a benchmark portfolio. Currently, publicly available benchmark asset allocation data – in particular, relating to domicile, listing, and hedging ratios for assets – is not sufficiently granular.

While we understand this data is proposed to be released as part of the granular datasets, the discussion paper is vague about the timeliness of the release, and it would be important to release the granular datasets with the performance test to allow users to conduct detailed analysis.

We appreciate that the key metrics dataset (which is proposed to be released quarterly from June 2022) will include additional information on domicile, listing and hedging for benchmark asset allocation. However, various categories corresponding to benchmark asset allocation portions for which domicile, listing or hedging information is 'Not applicable' or 'Not specified' have been combined or left out altogether.

For example, for equities, the Quarterly Product Level Publication template includes: Australian listed equity, Australian unlisted equity, International listed equity (hedged), International listed equity (unhedged), International unlisted equity (hedged), International unlisted equity (unhedged), Equity (domicile and/or listing not specified).

[7] Sy, W. and Liu, K. (2009) 'Investment performance ranking of superannuation firms', Working Paper, Australian Prudential Regulation Authority (APRA).

This will lead to imprecise calculations if one of domicile, listing or hedging has not been disclosed but the rest have been. It is preferable to include the extra categories to allow for precise calculation of performance test results, or ensure the granular datasets are released in a timely manner.

Recommendation: APRA should ensure that additional and up-to-date strategic asset allocation data is published to allow users to accurately calculate performance test results.

There also appear to be some inconsistencies in the asset allocation categories provided throughout various publications.

In the Annual Fund Level Publication template, the breakdown for Alternatives is: Australian Alternatives, International Alternatives, Alternatives (listing and/or domicile not specified). We assume the latter should be "Alternatives (domicile not specified)" for consistency with the preceding two categories. Furthermore, Commodities appears to have been allocated as a separate column despite being counted as Alternatives according to the amended reporting standards for SRF 550.0.

These two points are also reflected in the Quarterly Aggregate Publication template.

APRA should clarify these points to ensure the publications are more user-friendly.

Insurance fees

As part of the annual fund level publications, APRA proposes to calculate 'insurance fees' as the difference between premiums collected from members and premiums paid to insurers. This quantum is not a fee as it is not an additional amount charged to members and should not be identified as such.

Additionally, this amount can reflect differences in timing between the payment of premiums by members and by funds, which will typically balance over time but not within a year. As such, this metric should be calculated over a longer time horizon.

Recommendation: The publication of the difference between premiums collected from members and premiums paid to insurers should be calculated over a time horizon longer than a year.

Default insurance offering fund comparisons

As part of the annual product level publications, APRA proposes to publish data on default insurance cover design and cost for representative members. This includes consideration of the occupation category cover, cover level and insurance cover cost – however it does not include information about other factors that represent value when considering insurance, such as the claims ratio, acceptance rates, or claims handling experience.

Without these other factors, the published information could be misleading for members given it is not truly comparable and does not account for terms and conditions, nor different risk profiles of fund membership. This type of comparison at the product level will likely lead to members comparing policies on price alone – which would potentially leave them worse off.

More generally, the use of representative member examples may give the impression that a particular insurance product is suitable for someone of a particular age or cohort. However, insurance needs vary greatly depending on other factors specific to the individual – such as their pre-existing conditions, employment and family circumstances.

Recommendation: The publication of representative member examples should be subject to a separate consultation.

Proposed metrics

APRA should include the following additional metrics (beyond those in Attachment D of the discussion paper):

- Total investments (quarterly) – this is needed at the product level for performance testing and provides additional context alongside total assets.

- Advice fees and costs (representative member) and advice-related tax expense/benefit (representative member) – these are currently published in the Quarterly MySuper statistics alongside the corresponding administration series, in between net investment return and net return for a representative member. They have not been included in the Quarterly Product Level Publication template which resembles the current statistics most closely. Along with their use in performance testing, including these better reflects the difference between net investment return and net return for a representative member.

Regarding already proposed metrics, ISA notes that the four metrics titled "Proportion of members with Life Insurance", "Proportion of members with TPD", "Proportion of members with IP Cover" and "Proportion of members with cover" are calculated using the Number of Insured Members as the denominator, not number of members. The names of these metrics should be changed to reflect that they are the proportion of insured members and not the proportion of members. An additional data item reporting the proportion of members with insurance should be added.

Additionally, APRA should update the calculation of the percentage of assets to growth variable to reflect the updated reporting standards outlined in SRF 550.0. In APRA's latest MySuper Heatmap Methodology Paper released in December 2021, 50 per cent of the Other category are considered growth assets in the corresponding Heatmap's strategic growth asset allocation variable. The current proposals use updated reporting standards that exclude the Other category and instead include the categories of Growth Alternatives and Defensive Alternatives, yet still consider 50 per cent each of these as growth assets, according to the draft metrics. To better reflect the new categories as according to their name, Growth Alternatives should be considered 100 per cent growth assets and Defensive Alternatives should be considered 0 per cent growth assets.

Recommendation: APRA should add the following metrics: total investments (quarterly), advice fees and costs (representative member) and advice-related tax expense/benefit (representative member). APRA should also update the proportional insurance-related metrics and the calculation of the percentage of assets to growth variable to reflect the updated reporting standards.

Fees and costs arrangements

ISA supports the inclusion of various representative member balances to assist comparison between fee arrangements and returns of different products, but appreciates the flexibility to calculate alternate representative member scenarios using the granular datasets. Representative member balances used should include those published in heatmaps, along with lower and higher balances, to capture a range of individuals.

Performance

ISA agrees that publishing net returns in the key metrics publications based on the investment pathway with the highest fees and costs charged is important information for analysing member outcomes. However, even if the proportion of members in each pathway is published, the returns information may be relevant for very few members and is therefore not necessarily reflective of the typical outcome for members. It would be useful to include net returns information for the pathway with the most members, in addition to that for the pathway with the highest fees as proposed (and returns for the pathway with the lowest fees) to provide additional contextual information.

ISA also supports APRA's proposal to publish risk-adjusted returns using the Sharpe Ratio, along with data related to return objectives. Return Objective Target Returns should also be reported to provide additional context with which to understand a product's returns.

Confidentiality proposals

We appreciate that the confidentiality proposals in this discussion paper take into account feedback provided to APRA during the Phase 1 SDT consultation.

However, the proposals warrant further consideration to minimise the risk of commercial detriment to funds. We recommend that APRA consider not publishing additional data items in the expenses tables (SRF 332.0) and in relation to derivatives (SRF 550.2 – Table 1).

Expenses

Previous research by APRA[8] and more recent research[9] have revealed significant disparities in expenses ultimately incurred by members depending on the commercial model of the fund and whether related or unrelated service providers are used.

While publication of service provider expenses should in theory increase price transparency and market efficiencies there are two primary concerns arising from the publication of detailed data items relating to a fund's expenses that could impair the fund's capacity to negotiate a better deal for members.

- It could reveal the commercial terms of a particular service arrangement with a service provider – for example, the total cost of Fund A's service arrangement with Provider B for investment management services.
- More broadly, it would reveal the total amount a fund spends annually in relation to a specific expense type (and potentially their budget allocation for a specific expense type) – for example, the total amount spent by Fund A in a year on external auditing services.

It is plausible that the publication of such detailed data items could reduce a fund's bargaining power when negotiating new contracts in the same industry, resulting in funds having to pay more for these services and subsequently passing on these higher costs to members. Clearly, this is not in the best financial interests of members.

For example, revealing the total amount spent by a fund on a specific expense type could restrict the fund's bargaining power if they later consider consolidating those service providers. If Fund A uses four different accounting firms, while it may be more difficult to identify individual providers, it would not be difficult for users of the data to calculate the total amount paid by Fund A for its accounting needs. If Fund A wishes to use one accounting firm going forward, their bargaining power may be reduced as the prospective firm would know exactly how much Fund A currently pays.

While APRA's proposals to make the service provider identifier, name, and Australian Business Number confidential are a step in the right direction, we still have concerns about the publication of expense

[8] Liu K; Arnold B, 2010, Australian Superannuation Outsourcing: Fees, Related Parties and Concentrated Markets, Australian Prudential Regulation Authority, Australia, APRA Working Paper.
[9] Lui and Ooi 2018, The Impact of Related-Party Outsourcing and Trustee Director Affiliation on Investment Performance of Superannuation Funds (https://ssrn.com/abstract=3123499).

type (column 4 in SRF 332.0 – Table 2) and investment asset class sector type (column 4 in SRF 332.0 – Table 3). These are discussed in turn.

Expense type – Column 4 of SRF 332.0 – Table 2

Most funds will generally only have one or two service providers for a specific expense type. In those cases, it would not be difficult for third parties to identify individual service providers and the commercial terms of the particular service arrangement if the data in column 4 of SRF 332.0 – Table 2 is published.

Additionally, publishing the data in column 4 of SRF 332.0 – Table 2 would reveal the total amount a fund spends annually in relation to a specific expense type. This would occur irrespective of the number of service providers used by the fund in relation to that expense type.

In our discussions with APRA, we have been asked to consider whether these concerns could be overcome by APRA not publishing the expense type where a fund only has a small number of service providers for a specific expense type (for example – one or two service providers for that type). While this approach may mask some arrangements with individual service providers, the issue around revealing the total amount a fund spends in relation to a specific expense type remains where funds have many service providers for a specific expense type.

There are sound commercial reasons why funds may have multiple service providers for a specific expense type, particularly if the fund is large. Additionally, the market for each of the services is likely to change over time, which may subsequently influence the number of service providers a fund will have for a specific expense type. Accordingly, applying a principle where APRA does not publish the expense type where a fund only has a small number of service providers for the specific expense type is insufficient.

Similarly, we have reservations about APRA adopting an approach whereby only certain data items in the expense type column are made confidential. Given the market for each of the services is likely to change over time, this approach would require industry and APRA to revisit these data items frequently.

We appreciate that some of this data is already published by APRA and by funds in their financial statements, however it is far more limited than the data in column 4 of SRF 332.0 – Table 2.

Recommendation: APRA should consider not publishing the expense type (column 4 of SRF 332.0 – Table 2) in its publications. The service arrangement inclusions exclusions text (column 5 of SRF 332.0 – Table 2) should also not be published as it may reveal the expense type.

This could be achieved by making columns 4 and 5 confidential or through internal APRA policies about publication. We do not have a strong preference for either approach – however, if this is achieved through an internal APRA policy, the policy should be published on APRA's website.

We would also support this approach being used as an interim solution while further work is undertaken to determine whether the expenses could be grouped in a more meaningful way (that is – grouped in a way that is more detailed than expense group type (column 3) but less specific than expense type (column 4)).

This approach would also deal with the issue that some funds have relating to confidentiality clauses in contracts with service providers (i.e., that such confidentiality clauses could be contravened by APRA publishing specific information about their service arrangements).

Investment asset class sector type – Column 4 of SRF 332.0 – Table 3

Similar issues arise in the context of investment management expenses. The publication of the investment asset class sector type (column 4 of SRF 332.0 – Table 3) could allow users to cross-reference the data published by APRA with already publicly available information about funds' investment managers to determine the cost of individual service arrangements.

Recommendation: APRA should consider not publishing the investment asset class sector type (column 4 of SRF 332.0 – Table 3) in its publications. The asset class description text (column 7 of SRF 332.0 – Table 3) and service arrangement inclusions exclusions text (column 8 of SRF 332.0 – Table 3) should also not be published as it may reveal the investment asset class sector type.

Again, we consider that this approach would deal with the issue that some funds have relating to confidentiality clauses in contracts with investment managers.

Asset Allocation

The publication of several data items relating to a funds' derivatives holdings in SRF 550.2 – Table 1 (which are not required to be publicly disclosed under the portfolio holdings disclosure requirements) can reveal to market participants how the fund is engaging with the market. This includes the publication of the following data items:

- derivative exposure type (column 1 of SRF 550.2 – Table 1)
- derivative type (column 2 of SRF 550. 2 – Table 1)
- derivative gross positive market value amount (column 10 of SRF 550.2 – Table 1), and
- derivative gross negative market value amount (column 11 of SRF 550.2 – Table 1).

Publishing this data can allow banks to work out when funds may approach them to trade. This advantage means that banks can raise prices in anticipation, thereby imposing additional costs on funds. Clearly, this will have a negative impact on member outcomes.

Aggregating and publishing this data at an industry level is still problematic as it would allow market participants to position based on super sector exposures.

Delaying the publication of this data is unlikely to address these issues as derivative exposures generally do not change over the short term.

Another concern is that publishing derivative exposures isolated from risks being hedged could wrongly suggest that more investment risk is being taken than is actually the case.

Recommendation: APRA should not publish the derivative exposure type (column 1 of SRF 550.2 – Table 1), derivative type (column 2 of SRF 550.2 – Table 1), derivative gross position market value amount (column 10 of SRF 550.2 – Table 1) and derivative gross negative market value amount (column 11 of SRF 550.2 – Table 1).

Otherwise, we note that APRA's confidentiality proposals relating to asset allocation appear to be sufficient.

Other comments

While we have recommended that APRA should not publish the expense type (column 4 of SRF 332.0 – Table 2) in its publications, in the event APRA does – please note that we have concerns about the description of some of the expense types that are currently in column 4 of SRF 332.0 – Table 2.

In particular, that column includes 'Payments Or Donations to Industry Bodies', 'Payments Or Donations to Political Bodies' and 'Payments Or Donations to Trade Bodies'.

The conflation of "payments" and "donations" in this context is inappropriate given the two terms have different meanings under the law and in everyday usage. It will also likely result in misleading inferences being drawn about a fund's expenses.

Recommendation: If APRA does publish expense type information, payments and donations to the relevant bodies should be separated. For example, 'Payments Or Donations to Industry Bodies' should be separated into 'Payments to Industry Bodies' and 'Donations to Industry Bodies'. APRA should also ensure that the reporting requirements are aligned accordingly.