Superannuation transfer planning: Proposed enhancements

Deloitte response to consultation

10 March 2023

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General Manager, Policy
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10 March 2023

Dear [redacted]

Deloitte response to consultation on proposed enhancements to superannuation transfer planning

Please find enclosed the Deloitte submission in response to consultation on the proposed enhancements to superannuation transfer planning. We welcome the opportunity to respond and provide feedback on this.

The APRA discussion paper outlines proposed enhancements to the current Prudential Standard SPS 515 Strategic Planning and Member Outcomes (SPS 515) and Prudential Practice Guide SPG 227 Successor Fund Transfers and Wind-ups (SPG 227).

The introduction of the Annual Superannuation Performance Test and the attention on sustainability across the superannuation market has increased the focus on the inorganic growth activity of funds over the past three years. Whilst the response by some funds to such measures has been to tighten their cost models or make changes to their investment strategy to protect their performance, a relatively significant number of other registrable superannuation entities (RSE) licensees used this as the trigger to seek a merger with another RSE licensee to transfer members and assets[1].

We agree with the strong emphasis that has come through in recent prudential standards on reaffirming the focus on member outcomes and agree that given the trend on transfer activity shows no signs of slowing down, aligning the various prudential standards would support the industry further.

Our response focuses on the key themes that we would consider important to consider when making any updates to SPS 515 and SPG 227 to ensure that this supports the industry, whilst avoiding any unintended consequences which could have the opposite effect of enhancing transfer planning and implementation.

[1] Of the 13 funds with MySuper products that failed the APRA performance test in FY21, 10 have announced they are in the process of merging, or have already merged with another super fund.

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Yours sincerely,

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1 Response to Consultation

Our responses to the consultation questions are derived from our deep experience working with clients to understand and effectively implement SFT's and other transfer arrangements.

1.1 Transfer preparedness

<table>
<tr><th>Question</th><th>Deloitte Response</th></tr>
<tr><td>APRA proposes that all RSE licensees must regularly consider, and plan for, future circumstances that may necessitate a transfer of members into, and out of, the RSE licensee's business operations. Do you agree? If not, please provide views.

What are the minimum preparatory steps that an RSE licensee should take to be prepared for a transfer of members?

How would an RSE licensee look to balance being adequately prepared for a future transfer of members without incurring undue cost?</td><td>We support APRA's proposal relating to the requirement for RSE licensees to regularly consider, and where necessary plan for, future circumstances that may necessitate a transfer of all or some members.

We believe however that it will be important to consider the specific guidance provided under this item to ensure that the benefits of pre-planning are not ultimately outweighed by the costs. Currently the guidance states that:

"A prudent approach to planning would include:
• undertaking market scanning to identify credible transfer options and partners;
• ensuring that transfer options are regularly reviewed and updated so they remain relevant;
• exploratory discussions with potential transfer partners;
• provision of risk analysis to the Board to identify how and where the need for a transfer may arise; and
• the Board considering high level options for how and when a transfer of members may be implemented and how this integrates with other RSE licensee contingency planning"

<u>Potential barriers to efficient transfer planning</u>
A key barrier to an efficient transfer planning process is often a RSE licensee's expectations around the level of detail that is required at each stage of the Successor Fund Transfer (SFT) process. We agree that ultimately clear and robust contingency planning processes must be put in place. However, in developing a transfer plan, we believe a staged approach to the breadth and depth of analysis and information gathering is key and should be considered in the guidance.

Although the level of detail outlined above may be appropriate where a RSE licensee is likely to reach a trigger that would suggest a transfer would be in the beneficiaries best financial interest, the current guidance could be interpreted as being overly onerous when the RSE licensee has not necessarily reached a trigger that would require this to occur.

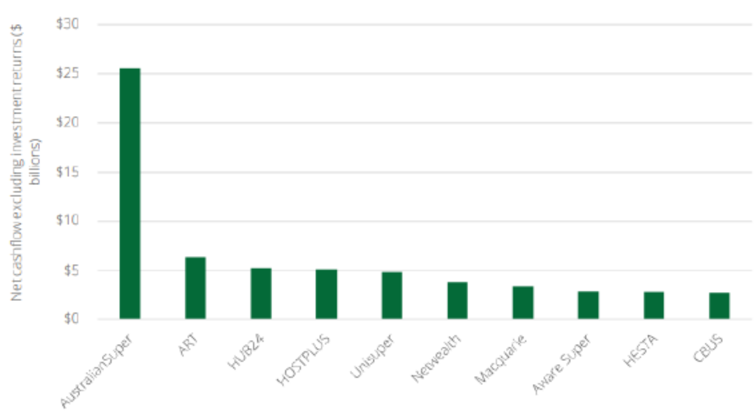
For example, the guidance to undertake a market scan to identify credible transfer options, regularly review this and instigate exploratory discussions with the fund should be overlayed with the level of detail that might be reasonably expected at this stage. As a first stage, it is expected that this process would be a filtering process based on key performance indicators rather than an in-depth analysis of the exact impact on all members across different transfer arrangements. Guidance should be articulated in a way that acknowledges the differences in circumstances.

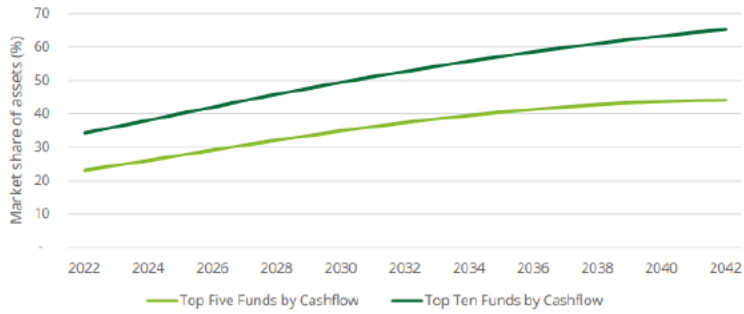
<u>Suggested minimum preparty steps</u>
The AIST Merger Toolkit includes a key first stage for funds considering their merger readiness which is focussed on developing a merger strategy and assessing their own</td></tr>
</table>

Question	Deloitte Response
	capability prior to entering merger discussions ie self-due diligence. Appendix A includes a check list of key items that a fund can utilise to assess their own merger readiness. There are also elements of the AIST Merger Toolkit which may support in developing the key parameters of the pre-planning stage. Appendix C of the AIST Merger Toolkit outlines a checklist of key criteria that RSE licensees should consider, where the majority of this can be sourced from public information and therefore streamline the market scan step. RSE licensee's developing a defined approach, based on defined data sources would then allow the "regular" review of this to be more efficient (noting that ultimately this would need to be reviewed in itself regularly, but should be less onerous than developing a new approach). In addition to the transfer planning activities outlined above which are outward looking, the pre-planning stage should also consider the RSE licensee's understanding of their own fund and potential barriers to transfer, along with the capability and resources required to action a merger for the transferring and receiving fund. In transfer activities across the industry, capability and resourcing is often cited as a key feedback point, with RSE licensees expressing the requirement for a careful balance of such processes, whilst also considering the impact this may have upon staff retention and hence the ability of the fund to maintain member services. A key consideration for funds in this phase is also considering what arrangements in the current fund could potentially cause an issue when preparing for a transfer e.g. special DB arrangements, existing remediation programs, tailored insurance arrangements or other special terms. These items are better to be considered early and addressed in order to allow a smooth transfer process to progress. The pre-planning stage will also need to capture the capacity in the market and the alignment between transferring and receiving funds. There may be longer term projects or existing transitions in motion which could impact upon the ability for a fund to accommodate the transfer. For example, one transferring RSE licensee may identify another as the preferred receiving RSE licensee but be unable to move the process quickly. The ability of a receiving fund to evidence that the transfer would be in the best interests of their members will be key and could be impacted by the timing.

1.2 Trigger frameworks

Question	Deloitte Response
What performance indicators do RSE licensees use to identify where a transfer of members is required? Of these, which indicators would be of most concern, for example, relating to performance, sustainability and service?	The key performance indicators considered by RSE licensees, based on our experience is: • The ability to run a sustainable operating structure and the projected build up or depletion of reserves • Operational resilience and the ability to operate critical operations • The Annual Superannuation Performance Test for MySuper products • APRA sustainability metrics – considering rate of member growth and net cashflows • The Trustee determination of whether the financial interest of member is being promoted in the member outcomes assessment – as defined by SPS 515, considering the key metrics and peer relative performance • Loss of key personnel The transfer activity that was triggered following the release of the FY21 Annual Performance Test results would suggest that this is a key trigger for RSE licensees, however this is expected to be more pronounced in the short-term. There are two key items to raise when considering triggers:

Question	Deloitte Response
	1. Larger is not always better The ability for some funds to continue to offer strong performance (as measured by the Annual Performance Test) within a reasonable fee range to members, and with comparable sustainability metrics. Additional considerations on the levels of service should overlay this assessment and with a smaller base, it is possible that these metrics may worsen over time. 2. Net Cashflows Deloitte's Dynamics of the Australian Superannuation System 2022 report was recently issued, where we discuss key factors impacting upon the industry. A key piece of analysis focused on the projected level of net cashflows across the industry. As the superannuation system matures, net cashflows (excluding investment returns) are projected to be net negative by 2032. Within the Not-for-Profit and Retail sectors there has been increased fund rationalisation in recent years, and we have continued to see mergers involving several of the larger players in the market. This has resulted in the development of much larger funds and some mega-funds dominating the superannuation space. While these funds often show the strongest cashflows, the list of funds in the top ten funds by positive cashflow varies significantly from the same list by funds under management (FUM).  Industry funds continue to make up the majority of this list, consistently showing strong organic member growth and contributions, with a low proportion of assets in retirement paying pensions. However, the HUB24, Netwealth, and Macquarie platforms have also shown strong growth off comparatively smaller asset bases. Excluding these funds, the rest of the superannuation market has net negative cashflow (excluding investment returns). The top funds in Graph 3 already manage a significant proportion of funds under management, even if they include several relatively smaller players. The graph below shows that, if these funds maintain the same relative difference in cashflows compared to the total market in today's dollars, they are projected to manage the majority of the assets in less than a decade, excluding any growth from merger activity.

Question	Deloitte Response
	 Whether these cashflows will be maintained remains to be seen, as they currently rely on growth from members transferring from other funds. The funds experiencing the equivalent negative cashflows are unlikely to remain in operation if this trend continues. However, a key consideration for those currently experiencing negative cashflows is the ability of the funds who are generating significant cashflows being able to prove that being the receiving fund and incurring the related costs would be in their members' best financial interest. I.e., what additional value would their existing members get and over what period of taking on a merger of a relatively smaller number of members.

1.3 RSE licensee decision making

Question	Deloitte Response
What guidelines would support an RSE licensee to ensure that appropriate due diligence is undertaken without resulting in undue cost and delays?	The preparations required to action an SFT stretches across the full fund and typically involves a significant number of workstreams. Often through this process there can be a combination of what would be classed as: • Due diligence – i.e. is this transfer in the best financial interest of the fund members and are there any reasons as to why this merger should not occur?; and • Implementation planning i.e. detailed plans related to how the merger would happen. The consequence of this is that in an effort for funds to progress the SFT quickly, there is a combination of due diligence and implementation planning being done concurrently. We would expect certain threshold issues to be investigated as a priority, and prior to the formal implementation planning commences. Guidelines on appropriate stage gates, with appropriate levels of due diligence required to meet the requirements of each stage gate could support in identifying key issues earlier, whilst also managing the costs and risks associated with the entire process. That is because the focus is placed on such threshold issues and the spend associated with more detailed implementation planning can be reserved for such times as this is required. Further guidance around the expectations of key stages gates and the necessary decision and due diligence to be done at each stage could support in avoiding undue costs and delays (ie entering an Memorandum of Understanding, entering a Heads of Agreement (HOA) and signing an SFT Deed). For example, this could encompass a roadmap for the execution of the HOA, informing on best practice expectations to better support funds in identifying the key items or principles that should be agreed prior to entering a HOA. Additional guidelines on the expectations of key items such as not entering into any new service provider agreements and the caretaker obligations of both funds over the period to ultimate SFT.

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<tr><th>Question</th><th>Deloitte Response</th></tr>
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<tr><td>Do you have any comments on the proposed requirements relating to the transfer of MySuper assets (refer to Attachment A)?</td><td>We have provided comments on potential additional considerations associated with the current drafting of Appendix A:

Impact on choice product holders – under the SIS Act, an RSE licensee has a general obligation to act in the best interests of the beneficiaries at all times. Therefore, the requirement of transferring the MySuper assets should also be considered in the context of choice assets to avoid any unintended consequences. For example:

Is the expectation that choice assets would transfer at the same time. If choice assets were not, then this would potentially lead to the RSE licensee disadvantaging choice product holders as a result of the transfer of MySuper assets (and the loss of economies of scale).
It is possible that efficiencies are lost by not transferring all members at the same time.
The MySuper and choice products are often comprised of the same underlying investments and therefore it could be difficult to practically split the groups of members and could also add significantly to the cost burden.
As a consequence of the above, there would be further consideration of how those costs are apportioned between transferring and remaining members.
The practical approach adopted where a member has both MySuper and choice assets.
These would need to be carefully considered from a member's best financial interest perspective by funds.

Transfer timelines when licence not cancelled – there could be an expectation that this would become the benchmark and even in instances where the licence as not cancelled, a similar timeline would be expected.
Transferring versus receiving fund – the ability to meet the 90-day timeline will rely on both the transferring and receiving fund being able to accommodate this. Therefore, the alignment in the ability for funds to action this is important.
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1.4 Barriers to transfer

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<tr><th>Question</th><th>Deloitte Response</th></tr>
<tr><td>What are the most significant barriers to a transfer of members, and how can the impact of these be reduced so that transfers are timely, orderly and less costly?</td><td>We have summarised what Deloitte have observed as being some of the significant barriers to a transfer of members.

Interpretation of requirements - For example, clear articulation of what is a right and what are features is required to avoid misinterpretation. Retention of clear guidance in SPG 227 to reiterate the differences in this area with illustrative examples can support RSE licensee's.

Engagement with third parties – RSE licensees rely on engagement and agreement of third parties, for example, superannuation or insurance administrators, where the timelines of transfer can stretch over 8-10 months. Engagement with third parties should perhaps be considered at a planning stage so that this can be incorporated into the pre-planning process. Regular updates from service providers on other transfer activity across their other fund clients may also support RSE Licensee's in meeting this requirement. Acknowledgment of this barrier in the guidance and details of how this can be addressed would support RSE's.</td></tr>
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Question	Deloitte Response
	APRA's view on mechanism for transfer – we have seen different mechanisms in the market for transferring members either via SFT, change of control, etc. Clearer guidance around expectations on the transfer approach and required engagement with APRA, along with anticipated timelines may support funds in decision making processes. **Negotiation** – the discussion regarding the SFT is ultimately a negotiation between two RSE licensees where each RSE licensee needs to act in their own members' best interests, up to SFT date. This can lead to extended discussions as both funds look to prioritise their own members. **Legislative mechanisms** – a clearer understanding of the areas where APRA can and cannot provide relief. For example, there could be a situation where a fund who has failed the performance test is required to send a letter to members to state this. For a receiving fund, the loss of members before the transfer could then impact upon the business case that they had already entered into to justify that the transfer was in their own members best financial interest. Also we have seen that the application by funds for relief e.g. the ability for a fund to run two MySuper licences for a short period of time, can be a lengthy and complex process. The uncertainty in the ability to obtain relief can therefore make implementation planning more difficult and hence have an impact on overall timelines. Clearer guidance from APRA regarding the circumstances in which relief can and cannot be granted could improve efficiencies in this area.

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