Mercer

welcome to brighter

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Discussion Paper - Strategic Planning and Member Outcomes: Proposed enhancements

Thank you for the opportunity to provide feedback on the matters raised in the above Discussion Paper dated 1 August 2022.

Mercer agrees that the introduction of Prudential Standard SPS 515 *Strategic Planning and Member Outcomes* (SPS 515) has resulted in a significant uplift in both strategic planning and the focus on member outcomes across the superannuation industry. We also agree there is room for improvement in the requirements and it is timely to consider enhancements.

Our responses to a number of the specific questions raised in the Discussion Paper are set out in the Appendix. These responses are based on the experience and input from both:

- Mercer Superannuation (Australia) Ltd ("MSAL"), as the Trustee of the Mercer Super Trust; and
- Mercer Consulting (Australia) Pty Ltd ("MCAPL"), which has provided consulting services to a number of clients with respect to SPS 515.

Where we considered it important, we have indicated which entity's perspective is being provided.

About Mercer

Mercer believes in building brighter futures by redefining the world of work, reshaping retirement and investment outcomes, and unlocking real health and well-being. Mercer's approximately 25,000 employees are based in 43 countries and the firm operates in 130 countries. Mercer is a business of Marsh McLennan (NYSE: MMC), the world's leading professional services firm in the areas of risk, strategy and people, with 83,000 colleagues and annual revenue of over $20 billion. Through its market-leading businesses including Marsh, Guy Carpenter and Oliver Wyman, Marsh McLennan helps clients navigate an increasingly dynamic and complex environment.

In the Pacific region, Mercer Australia is a trusted adviser and guardian to our clients and members. We look after the superannuation benefits of over two million members in over 30 large superannuation funds, including corporate stand-alone funds, public sector funds, industry funds and the Mercer Super Trust (which includes approximately 230 corporate clients). We provide customised administration, technology and total benefits outsourcing solutions to our clients, and our expertise in administering and managing the investments of diverse, complex superannuation benefit designs is well recognised. Our clients include some of the world's leading organisations in both the public and private sectors, as well as many smaller rapidly growing organisations seeking best practices in order to gain competitive advantage.

We would be happy to discuss this submission in more detail at your convenience. Please do not hesitate to contact me to arrange.

Yours sincerely,

[redacted]

[redacted]
Senior Partner

Appendix

Responses to specific questions from the Discussion Paper

1. Which, if any, provisions in the SPS 515 framework have worked well in improving business planning? Which, if any, provisions have caused unintended consequences? Please provide details.

Worked well

MCAPL has observed an overall significant uplift in strategic planning across the superannuation industry since the introduction of the SPS 515 framework and APRA should be commended for this.

Having access to publicly available data (e.g. APRA quarterly and annual statistics, APRA MySuper and Choice Heatmaps) has meant funds can compare themselves to their peers, competitors and the whole industry more easily. However, more detailed information is now required for funds to be able to analyse more deeply and be more impactful (see answer to question 4).

Unintended consequences

- Mercer understands it is a SIS Act covenant that trustees must determine they are promoting members' best interests, otherwise they are breaking the law. Unsurprisingly every trustee (apart from one we are now aware of) determined that every product in the industry promoted members' best interests. If there was more flexibility for trustees to determine that products needed improvement, without breaching the SIS Act, then it is more likely for the Business Performance Reviews to be an open and honest look into the trustee's operations.
- Linked to the point above, there is a tendency for trustees to attempt to only perform analysis that will show them in a favourable light and avoid (or ignore) analysis that provides negative results. This is particularly true with respect to the website summaries as they are publicly available.
- It is interesting that net returns are considered separately to investment and administration fees, when the investment and administration fees are already incorporated into the net returns (SRS 702 item 4.3). Calling out fees separately appears to add more weight to them when ultimately the best investment returns net of all fees should be the primary metric for accumulation products.
- The MySuper and Choice Stage 1 Annual Outcomes Assessment (AOA) requires a comparison of the level of investment risk (using the expected numbers of years with negative returns in the next 20 years) with the rest of the superannuation industry (with respect to MySuper) and across similar investment options (with respect to Choice). It is hard to tell anything from this test because each product is designed to have a certain level of risk and whether that is more or less than another product does not say much by itself. For lifecycle products you tend to see higher levels of risk for younger cohorts and lower levels of risk as members age. But that is the design, so there is nothing flawed about it. Combining the level of investment risk with the returns analysis can provide greater insight.
- Certain analysis suggested by SPG 516 is difficult to perform due to the lack of data or an appropriate methodology, for example:

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- – Assessing the usefulness of the options, benefits and facilities provided by a fund compared to the cost of these services.
- – Assessing the retirement products offered to members and whether they address their needs. This is a challenge that has been highlighted as part of the Retirement Income Strategy work recently completed by the industry.

- Whether intended or not, there has been an increased focus on scale with the implication that small funds are not acting in members' best interests. However, there are niche funds that perform very well for their members and provide strong investment performance and/or access to sophisticated insurance arrangements. These funds should not be put under pressure to merge simply due to their smaller scale.

Defining member outcomes

2. Has APRA correctly identified the areas for enhancement? What additional areas could benefit from enhanced requirements or guidance to support effective strategic planning and delivery of outcomes to members?

We agree from an industry-wide perspective that there is considerable scope for better use of cohort analysis, which we understand should be directed principally at identifying member cohorts where outcomes are less favourable (than for members overall) and where the trustee may be able to take action to address this. We also agree that APRA should maintain a principles-based approach to requirements for setting cohorts, rather than seeking to specify cohorts that must be adopted.

However we question the proposed new requirement that 'an RSE licensee demonstrates why the cohorts are reasonable in the context of the relevant RSEs'. This might be interpreted as requiring a trustee to demonstrate why it was unnecessary to adopt other cohorts, which would be problematic. A more workable alternative may be to require trustees to set out how their cohorts were determined and how this aligns with the purpose of undertaking cohort analysis.

In terms of further guidance, the issue of how to measure whether post-retirement products are meeting members' needs and improving outcomes is a challenge the whole industry is wrestling with due to the RIS requirements. While we think it may be premature for APRA to issue formal guidance at this early stage of development of ideas, we support APRA's intention to play a supportive role in advancing dialogue and solutions with the super industry and other stakeholders – see our response to Q 14 for related comments.

Cohorts

3. What additional guidance could be provided to help inform the development of cohorts?

SPG 516 currently provides very limited guidance on the practical application of cohorting from a case study perspective. We would encourage APRA to share some examples of better cohorting completed by funds over the last couple of years, including how the funds approached the determination of cohorts. This would provide other funds with examples of good practice to aspire to and new ideas to implement.

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Pre- and post- retirement cohorts

4. What challenges, if any, has industry faced in developing cohorts of members for the purposes of the retirement income strategy?

The greatest challenge was the lack of holistic data on the fund membership. The membership data held by super funds is limited and narrow, making it difficult to assess a member's true financial circumstances. For example, a fund is not able to see if a member is partnered, or if they own a home. Therefore, the cohorts and subsequent strategies that were developed were left at a high and incomplete level.

We would encourage discussion about the feasibility of the ATO, possibly partnering with the ABS, providing funds with more information on their members based on Government-held data, taking into account privacy protection requirements. This would allow funds to cohort more accurately and be better placed to create appropriate bespoke retirement income strategies.

Management of financial resources on a business-as-usual basis

5. To what degree would taking the above approach to financial management, including adoption of performance measures, monitoring and stress testing, differ from current practices? How might such obligations be implemented without undue regulatory burden?

Each year the MSAL Board reviews the business plan and financial projections underlying the business plan. These are stress tested and tracked quarterly with reporting of various aspects provided to the Board. It would be useful for APRA to provide examples of "financial management related performance measures". This would help the Trustee understand how the new requirements differ from current practices and what the increased regulatory burden might be.

6. What, if any, unintended consequences may arise from these proposed requirements? Please provide details.

More information is needed about the intended requirements before this can be assessed.

Financial resources to manage and respond to operational risk

7. Given the scope of the current requirements in SPS 114, much of the financial resources to manage and respond to operational risk have, necessarily, been met through existing reserves. How do RSE licensees presently use their financial resources to minimise the impact of operational risk events on members?

- MSAL outsources all of its major services.
- When an operational risk event occurs the Trustee first considers whether a service provider is liable to compensate the Trustee for the event.
- If not, the Trustee will then consider whether any applicable insurance arrangements can be called upon to meet the costs of the operational risk event.

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- If the insurance policy will not cover the event, the Trustee will consider whether the event constitutes an operational event and then follow the steps outlined in the ORFR policy.

Board oversight of projections

8. How does the Board currently satisfy itself that a robust financial projections methodology underpins the business plan? How does the Board intend to develop its use of financial projections (and assumptions underpinning them) presented in the business plan?

The MSAL Board satisfies itself that the financial projections underpinning the business plan are robust by:

- Having a layered review process that includes the Mercer Finance team, Mercer Super Product team and Mercer Super CEO before being passed to the Board;
- Ensuring key assumptions are articulated clearly in the business plan; and
- Reviewing against historical quarterly reports to ensure the actual finances are generally well aligned in year 1 of the business plan projections (adjusting for market impacts and new business assumptions).

Fee setting principles

9. What additional fee setting principles should be reflected in the SPS 515 framework?

- Fees need to be easily comparable from the publicly available information (e.g. Heatmaps and Super Data Transformation).
- There are still difficulties comparing like for like where funds use reserves to meet operational costs, insurance costs may be gross or net of tax and special events (such as a merger) may impact on costs.

The performance assessment cycle

10. What challenges have RSE licensees experienced in aligning the timing of the member outcomes assessments and annual BPRs and business planning cycles? How might these challenges be avoided in future?

As Mercer and the Mercer Super Trust use a calendar year business planning cycle, the MSAL Strategy and Business Plan (SBP) is updated in November. The Annual Outcomes Assessment (“AOA”) completed in February each year as at the previous 30 June may have lost considerable relevance by the time the Business Performance Review (BPR) is completed as the data is over a year old. The Trustee has instead taken to performing additional analysis as at the current 30 June (e.g. the date of the next AOA) for the BPR, in August and September, to allow the SBP to be updated and signed off by the Board in October and November.

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For funds/trustees that have a financial year end business planning cycle, MCAPL is aware of funds having difficulty completing all the BPR requirements (AOA in Jan/Feb and cohort analysis in Mar/Apr) prior to updating their SBP in May/June. If APRA were able to release the 30 June MySuper statistics earlier in Nov/Dec then this would help ease the strain on these funds.

Benchmarks

11. How have RSE licensees incorporated the result of APRA's heatmaps and the legislated performance test into their BPRs?

APRA's Heatmaps and the performance test have been used in AOAs and BPRs as a source of measurement of member outcomes. By highlighting where the fund sits in comparison to industry through the Heatmaps, trustees can highlight how their fees, returns and scale compare to industry.

12. What additional benchmarks do RSE licensees consider when assessing performance? In determining an overall assessment of outcomes, how are the various benchmarks weighted?

Additional benchmarks

- Index, composite SAA and competitor returns for investment returns.
- Rating house dashboards for administration and total fee comparisons.
- Net Promoter Score (NPS), rating house certifications and awards for member services.
- Independent advisor reports for insurance offering and premium benchmarking.
- Retirement readiness index or projections at retirement on whether the members are expected to have sufficient funds at retirement to have a quality lifestyle.
- Fund scale and operating costs from APRA statistics and rating house dashboards.

Weightings

We note there is no requirement in SPS 515 for specific weightings and our observation is that trustees have not generally adopted a formulaic approach to determine an overall assessment with specific weights and scores for different benchmarks. Having said this, strong consideration is commonly given to net return performance (which implicitly incorporates investment and administration fees) as the primary driver of member outcomes, along with the insights obtained from the results and analysis of this metric and other benchmark outcomes.

Data

13. What additional areas of data would be useful in developing comparable assessments of performance?

Currently the most challenging areas are comparing insurance offerings and member services across the industry. We note that APRA was planning to extend the APRA Heatmaps to include insurance offerings and we expect that this data will be helpful when it becomes available.

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For member services, NPS, rating house certifications and awards are often considered as it is difficult to find objective whole of industry data. This may be a matter to consider in APRA's Superannuation Data Transformation project.

14. What data (including benchmarks) do RSE licensees plan to use to develop retirement cohorts and assess performance of post retirement income strategies?

In our observation, this work is still at an early stage of development across the industry, with the need to assess retiree outcomes with balancing returns, risk and access to capital being particularly challenging.

We support APRA's commitment to an industry-led approach to the implementation of the retirement covenant, acknowledging that this will take time. Mercer certainly intends to contribute our views and ideas to the industry discussion about how best to do this.

We also support APRA's intention to play a supportive role in advancing dialogue and solutions with the super industry and other stakeholders.

As better ideas and practices emerge, we see a role for APRA in building awareness and encouraging consideration of these innovations across the industry, such as through Insight articles or 'light touch' guidance that is careful not to stifle further development and innovation by conveying expectations that certain practices should be used.