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Submission on draft Prudential Practice Guide SPG 516 – Business Performance Review

Dear Ms Richards

Industry Super Australia **(ISA)** appreciates the opportunity to provide comment on the proposed draft Prudential Practice Guide SPG 516 – Business Performance Review (**SPG 516**).

Summary

ISA welcomes the focus on member outcomes by government contained in recent legislative amendments[1]. It is long overdue and has potential to protect and advance the interests of superannuation fund members.

Superannuation trustees are waiting for the making of regulations set out in s 52(9) of the Superannuation Industry (Supervision) act 1993 (SIS Act) which will support the member outcomes laws and set benchmarks licensees must use to determine whether the financial interests of members are being promoted. The regulations when made will provide a standardised and objective framework for trustees to assess the net returns delivered to beneficiaries for MySuper products, choice products and the fund as a whole.

Unfortunately, APRA's proposed prudential guidance appears to have been drafted without reference to standardised performance benchmarks and as a result adopts an overly cautious approach that risks being ineffectual and clearly fails to realise potential of these laws. In place of robust and consistent measures that will improve outcomes for millions of members, the proposed guidance takes an approach that invites inconsistent, divergent and potentially self-serving approaches to performance and outcomes being adopted by some funds.

There are some important inconsistencies between the proposed guidance and the Revised Explanatory Memorandum[2]. For example, the memorandum articulates the purpose of the outcomes assessment as follows:

> '2.23. …the outcomes test provides trustees with a framework for assessing their product offering to determine whether it is achieving its intended outcomes and how it may be improved. The framework for the outcomes test endeavours to support the trustee's primary obligation to promote the financial interests of their members, in particular the net returns to those members.
>
> 2.24 A more comprehensive assessment of MySuper and choice products will make trustees more accountable for their products and enhance APRA's ability to take specific action to ensure the trustee rectifies the performance of their product where the financial interests of members are not being effectively promoted.' (page 17)

[1] Amendments to the Superannuation Industry (Supervision) Act 1993 **(SIS Act)** which followed the passing of the Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No.1) Bill (Member Outcomes Bill)

[2] Revised Explanatory memorandum to the Member Outcomes Bill

In contrast the draft practice guide issued in December 2018 suggests:

> 'The primary purpose of the outcomes assessment is to require the RSE licensee to assess the member outcomes resulting from its business decisions made in accordance with its strategic objectives and business plan, and the extent to which these outcomes could be improved. Thus, while RSE licensees are expected to be aware of the performance and products offered by other RSEs and relevant benchmarks, the assessment is not solely a comparative process.' (paragraph 3)

Draft SPG 516 adopts a similar approach and states:

> '*Prudential Standard SPS 515 Strategic Planning and Member Outcomes* (SPS 515) requires an RSE licensee to undertake an annual business performance review to assess its performance in achieving its strategic objectives and to determine what action it might take to improve performance. The business performance review incorporates the annual outcomes assessment under section 52(9)-52(11) of the SIS Act. SPS 515 sets additional specific prudential requirements in respect of the outcome assessment.'(paragraph 1)
>
> 'It [*the business performance review*] prompts an RSE licensee to determine whether its decisions support achievement of its strategic objectives' (paragraph 2)

So whilst the explanatory memorandum articulates the outcomes assessment around the trustees' primary obligation to promote the financial interests of members (measured by net returns), the guidance seeks to ground the assessment with reference to the entities own 'strategic objectives'. This risks promoting an inward looking assessment where the trustees pay insufficient regard to the financial outcomes they are achieving for members compared to the financial outcomes delivered by others utilising superior strategic objectives and business planning.

Draft SPG 516 forms part of a framework whose objective should be to ensure that members interests are promoted and protected. Instead it presents as a wasted opportunity to improve member outcomes and will do little to address underperformance if implemented in its current form. ISA raised these concerns with APRA when we gave feedback on draft Prudential Standard SPS 515 Strategic Planning and Member Outcomes (SPS 515)[3]. As we said in our feedback, if there is a genuine desire to promote the financial interests of members, then trustees must be required to prioritise long-term net returns using rigorous and objective measures. This should be the central focus of any outcomes assessment and not lost in other less than critical (often subjective) outcome objectives.

Specifically S52(9) of the SIS Act requires trustees to assess financial outcomes delivered to beneficiaries for MySuper products, choice products (s 52(9)(a)) and for the fund as a whole (s52(9)(aa)). The assessment for MySuper and choice products has two parts:

- a comparison of MySuper and choice products with similar products; and
- a comparison of the MySuper products and choice products to objective benchmarks.

The assessment for fund level outcomes is with reference to a fund portfolio tailored benchmark. The assessment of fund level outcomes is necessary to capture costs (such as advice and buy sell spreads) that will not be evident in option level benchmarking utilising unit pricing or crediting rates. Such costs affect the net returns accruing to the member and are often an unavoidable cost for members utilising choice investment platforms.

[3] ISA submission dated 29 May 2019

Detailed proposal
Performance benchmarks are an integral component of the member outcomes regime. For performance benchmarks to provide an impetus for underperforming funds to improve performance or leave, they must be rigorous, robust and fairly applied. They should also be standardised.

APRA should reflect on the benchmarking approach adopted by the Productivity Commission in its recent review and relevant technical supplement. This included utilising standardised market indexes for underlying asset classes and reasonable investment costs. It would not be unreasonable for APRA to anticipate that the regulations will adopt a similar approach.

In ISA's view:

- Benchmarking for the purposes of member outcomes should be tailored to underlying portfolio of assets comprising the fund, product, and investment option;
- Standardised investment and administrative costs should be applied to the portfolio benchmarks;
- Benchmarks should be constructed to match the longevity of a fund, product, or option and where possible assess returns over the short, medium and long term;
- Where relevant, all costs borne by the member should be incorporated including advice;
- Additional benchmarking will be necessary for default MySuper products to connect members to objectively high performing funds;
- Trustees should specifically assess how the outcomes of choice investment options compare to MySuper and whether members best interests are served by remaining in underperforming choice investment options.

SPS 515 and draft SPG 516
When undertaking an outcomes assessment for MySuper and choice products the licensee must compare the following factors set out in section 52(10) and section 52(10A) SIS Act:

- The fees and costs that affect the return to members;
- The return (after deduction of fees, all costs and taxes)[4];
- The level of investment risk;
- Any other matter set out in the prudential standards.

APRA's standard is silent as to the weight a licensee should give to each factor. This allows licensees to weight these factors in any way they chose to present products in the best light. Clearly, this level of discretion will inevitably undermine the robustness of any comparisons, enabling some licensees to justify products that would otherwise be regarded as underperforming on objective measures. For example, a trustee with high fees and costs and poor returns could seek to distract from this by giving greater emphasis to investment risk.

[4] Section 52(10A) is silent as to whether the return for choice products is after the deduction of fees, costs and taxes

SPG 516 rests on the flawed guidance in SPS 515. Paragraphs 62 and 63 of SPG 516 entrench the discretion given to licensees to balance the comparative factors referred to above by allowing licensees to decide the relative weight given to net returns. Paragraph 63 states that:

> '*The outcomes assessment requires an RSE licensee to reach a conclusion about the promotion of financial interests of the members that hold the product. As a consequence, an RSE licensee should ensure **sufficient weight is given to the net returns delivered to members***' [our emphasis].

ISA considers that prioritising net returns is the most effective way of assessing and comparing fund performance as it captures what goes into a member's account. There is no opportunity to hide fees and costs. Adopting a horizon that matches the longevity of a fund, product, or option, is needed as some products can appear to have high net returns over a short period because of positive bounces in listed markets yet perform poorly over longer periods.

APRA knows from its own supervisory experience that given the looseness of this wording some trustees who offer relatively poor medium to long term net returns to their members will exploit the discretion they have been given to give priority weight to secondary measures such as service quality.

APRA has also effectively exempted licensees from undertaking an outcomes assessment for choice products until regulations are made setting benchmarks (paragraph 75). This is not a tenable position given the findings of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* and the report of the *Productivity Commission Inquiry, Superannuation: Assessing Efficiency and Competitiveness*. This position also fails to reflect the will of the Parliament in amending the SIS Act to ensure that the annual outcomes assessments apply equally to MySuper and choice products. We also note that SPS 515 requires trustees of MySuper products to apply the methodology in (Draft) *Reporting Standard SRS 702.0 Investment Performance*, however there is no requirement for trustees of choice products to adopt the same approach.

ISA's view is that the absence of regulations should not be an impediment to licensees undertaking the legislated outcomes assessment which commences on 1 January 2020 for choice products. Superannuation is compulsory and underperformance in MySuper and choice products should be measured in the same way and at the same time. Research shows that consumers are often switched by financial advisers from good performing MySuper products into poor performing choice products[5]. This supports the argument that consistent performance benchmarks are needed in the MySuper and choice sectors to enable consumers and their advisers to make appropriate decisions and for Regulators to take appropriate action.

ISA appreciates that there is no publicly available, authenticated data for choice products however it does not accept arguments that licensees of choice products cannot undertake the legislated outcomes assessment. Licensees of choice products can still compare underlying performance options. To delay this assessment for choice products disadvantages the interests of members. Analysis by the Productivity Commission shows that choice products underperform MySuper products[6].

ISA recommends that APRA should adopt an approach which is clear, objective, robust and fair to both MySuper and choice products now and make it clear that net returns reflective of the longevity of the product must be prioritised by licensees above other factors.

Finally, ISA notes the draft guidance pays little or no regard to the cost of advice borne by members. This is inappropriate noting such costs can be significant and an unavoidable cost of accessing certain choice strategies. Whilst historically commissions were built into unit pricing this is no longer the case and percentage-based advice fees will not be captured when benchmarking data is collected by ratings agencies.

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[5] Member Switching, Rice Warner, 12 September 2017 https://www.industrysuper.com/assets/Documents/e505f89597/Rice-Warner-Industry-Super-Member-Switching-180917-FN.pdf

[6] Figure 2.7 of the *Productivity Commission Inquiry, Superannuation: Assessing Efficiency and Competitiveness*

If you wish to discuss this submission, please contact Ella Cebon at [redacted].

Kind regards

[redacted]

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