

Wednesday 16 October 2019

Heidi Richards  
Executive General Manager - Policy and Advice Division  
Australian Prudential Regulatory Authority  
12/1 Martin Place  
Sydney NSW 2000

Dear APRA

### **Revised SPG 516, Business Performance Review**

Super Consumers Australia welcomes the opportunity to comment on proposed revisions to Superannuation Practice Guide SPG 516, Business Performance Review (BPR), to accompany Superannuation Prudential Standard SPS 515 (Member Outcomes).

We think both the Prudential Standard and Practice Guide should reiterate and emphasise a strong focus on superannuation fund trustees driving and delivering improved member outcomes, including against their competitors, rather than providing a checklist for an RSE licensee compliance department.

We are particularly concerned that APRA has missed an opportunity to introduce a simple standardised measure of product performance (returns net of fees, costs, and taxes), to require trustees to collect useful cohort data and better engage with members (member surveys), or to provide clarity on the possible consequences for failing to comply with the new standard.

The sections of the SIS Act relating to the new outcomes assessment, s52(9)-(12), are a confusing loop of co-dependent clauses dictating how to conduct performance and benefit comparisons. SPS 515 and SPG 516 could be used to provide greater clarity for trustees, as implied at s52(11)(e), rather than continually referring back to the legislation.

We made 12 recommendations to improve member outcomes and sharpen the focus of SPS 515 in an earlier submission in June, most of which have not been incorporated. In this submission we urge APRA to reconsider our earlier suggestions in the revised practice guide SPG 516.

## **Summary of recommendations**

*Recommendation 1: that APRA implement a simple policy to clearly label successive versions of public consultation documents.*

*Recommendation 2: that APRA amend SPG 516 to require RSE licensees publish summaries of current and previous BPR.*

*Recommendation 3: that APRA, upon completing data collection on choice products, amend SPG 516 to use 'returns after the deduction of fees, costs and taxes' as the appropriate standard performance measure in all BPRs for both choice and MySuper products.*

*Recommendation 4: that APRA amend SPG 516 to include robust definitions of 'appropriate' and 'independent', to prevent any misunderstandings or further dishonesty; and that APRA also establish a vetting process to ensure that RSE licensees are not using consultancy firms that have a demonstrated history of dishonest or unethical practice.*

*Recommendation 5: that APRA amend SPG 516 to use returns after the deduction of fees, costs, and taxes as the appropriate standard performance measure for comparing product level returns, and for comparing product level returns against a benchmark portfolio, tailored to the asset allocation, and constructed with listed indexes.*

*Recommendation 6: that APRA include a 'right to remain' threshold test in the regulatory architecture, such as underperformance relative to their tailored benchmark by at least 0.5 percentage points over an eight year period.*

*Recommendation 7: that APRA amend SPG 516 to state that underperforming funds will be required to rectify their shortcomings within one year of receiving notice or face revocation of their MySuper license or direction to withdraw the underperforming choice investment option.*

*Recommendation 8: that APRA amend SPG 516 to require conducting a cohort analysis to review the suitability of each type of insurance cover and product design. This should include, but not be limited to, demographic factors such as age, gender, income, balance size, those in intermittent or casual work, and number and age of dependents.*

*Recommendation 9: that APRA amend SPG 516 to mandate the design and implementation of a compulsory, standardised representative annual survey of fund members, to assess levels of awareness and understanding of superannuation product features.*

## **1. Version labelling**

We recommend that APRA implement a simple policy to clearly label successive versions of public consultation documents. This particular consultation required comparing and evaluating changes to three versions of SPG 515, from December 2018, April 2019, and August 2019; and there was no easily identifiable markings in either the cover, header or footer to allow a reader to distinguish between them. This is a basic oversight that we urge APRA to address.

*Recommendation 1: that APRA implement a simple policy to clearly label successive versions of public consultation documents.*

## **2. Publishing summaries**

While we note that SPG 516 paragraph 104 requires member outcomes to be published, and that the stated intention of BPRs is to report to the RSE board (SPG 516, paragraph 51), we reiterate our earlier recommendation that RSE licensees publish summaries of current and previous BPRs.

These summaries should be in a standardised format, so that current and prospective superannuation members can better evaluate the decisions being made with their retirement savings and compare the published member outcomes assessments of other funds.

An instruction to publish summaries could be included in SPG 516 after paragraphs 51-53.

While we accept that not all members will have the time or inclination to read these summaries, they would provide a useful resource for third parties, such as consumer organisations and ratings agencies to incorporate into their own consumer or business facing information.

*Recommendation 2: that APRA amend SPG 516 to require RSE licensees publish summaries of current and previous BPR.*

## **3. Comparative test**

The inability to compare choice products is a widely acknowledged problem. There is an opportunity for APRA to introduce measures to help trustees (and prospective members) to better compare choice products in SPS 516 and SPG 516.

There is a different comparative test for choice and MySuper product in the member outcomes assessment in s52 of the SIS Act. At s52(10)(b), trustees comparing MySuper products must compare returns 'after the deduction of fees, costs and taxes'. At s52 (10A)(b), trustees comparing choice products are obliged only to 'compare returns', making accurate and effective comparisons impossible.

As a matter of urgency, APRA needs to collect standardised data for choice products (after the deduction of fees, costs and taxes) to enable like-for-like comparisons. Upon completing this task we recommend that SPG 516 uses '*returns after the deduction of fees, costs and taxes*'

(‘net of everything’) as the appropriate standard performance measure to be used in all BPRs for both choice and MySuper products. This would harmonise the treatment of choice and MySuper products and enable like-for-like comparisons.

*Recommendation 3: that APRA, upon completing data collection on choice products, amend SPG 516 to use ‘returns after the deduction of fees, costs and taxes’ as the appropriate standard performance measure in all BPRs for both choice and MySuper products.*

#### **4. Independent experts**

We note that SPG 516 paragraph 9 notes that in certain circumstances, an RSE licensee may (voluntarily) engage external consultants to assist with the BPR.

There was evidence in the Banking Royal Commission that AMP executives altered a so-called ‘independent’ report from law firm Clayton Utz. It is unfortunate that measures to protect the independence of external experts are needed.

We want to see APRA taking an active role in ensuring superannuation funds are appointing suitable experts to assist with BPR’s. We urge APRA to establish a vetting process to ensure that RSE licensees are not using consultancy firms that have a demonstrated history of dishonest or unethical practice.

We strongly support APRA’s power to force an RSE licensee to appoint an independent expert to report on the licensee’s BPR, as stated in paragraph 17.

*“APRA may require an RSE licensee to appoint an appropriate independent expert to provide a report to APRA on a particular aspect of an RSE licensee’s business performance review, within a timeframe agreed to by APRA. An RSE licensee must bear the costs of such an appointment.”*

We reiterate our earlier recommendation that APRA define ‘appropriate’ and ‘independent’ expertise, particularly with respect to the possibility that external consultants may have conflicts of interest. We suggest adding additional terms in SPG 516 paragraph 9, to include conflicts of interest:

Where an external expert or service provider contributes to the business performance review, this should be clearly documented, including a summary of [**any explicit or potential conflicts of interest, and**] the review or validation activity undertaken by the RSE licensee.

*Recommendation 4: that APRA amend SPG 516 to include robust definitions of ‘appropriate’ and ‘independent’, to prevent any misunderstandings or further dishonesty; and that APRA also establish a vetting process to ensure that RSE licensees are not using consultancy firms that have a demonstrated history of dishonest or unethical practice.*

## **5. Outcomes Assessment**

The prudential Standard SPS 515 requires the BPR to identify two components of investment performance:

1. Paragraph 15(a)(ii) refers to *objective internal and external benchmarks*;
2. Paragraph 15(a)(iii) refers to the *outcomes assessment* under s52(9) of the SIS Act, which codifies a different standard for comparing the returns of choice and MySuper products.

As noted in recommendation 3, the prudential guide SPG 516 should use '*returns after the deduction of fees, costs and taxes*' ('net of everything') as an appropriate standard performance measure for comparing and evaluating actual investment returns to beneficiaries. It is used in the Productivity Commission inquiry report and is legislated in the s52(9) test for MySuper products at s52(10)(b), but not for choice products at s52(10A)(b).

The Productivity Commission also recommended comparing product net returns with a benchmark portfolio, tailored to the asset allocation, and constructed with listed indexes.

These could be combined into a single, semi-standardised investment performance analysis that can be used across the industry. This would provide clarity and focus for trustees, reducing the scope for cherry-picking metrics and inappropriately weighting less important outcomes.

These standards (the use of 'returns net of fees, costs and taxes'; and the use of benchmark index portfolios) could be incorporated by further amendments to SPS 515 paragraph 15 to provide a standardised measure of investment performance across the industry; and/or by including both in SPG 516.

*Recommendation 5: that APRA amend SPG 516 to use returns after the deduction of fees, costs and taxes as the appropriate standard performance measure for comparing product level returns, and for comparing product level returns against a benchmark portfolio, tailored to the asset allocation, and constructed with listed indexes.*

## **6. Right to remain**

We urge APRA to include a 'right to remain' threshold test in SPG 516, to reduce the likelihood that RSE licences will attempt to game the elevated outcomes test, such as the example proposed by the Productivity Commission.<sup>1</sup>

The Productivity Commission recommended that all MySuper and choice products are subjected to elevated outcomes tests in order to earn the 'right to remain' in the system; and that products would fail the test if they underperform relative to their tailored benchmark by at least 0.5 percentage points over an 8 year period.

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<https://www.pc.gov.au/inquiries/completed/superannuation/assessment/report/superannuation-assessment.pdf>, see overview, page 37, and section 10.4, from page 488

The Productivity Commission work in this area is an important point of reference for APRA when determining what an appropriate benchmark would be. The eight year period allows for the effects of short term market volatility, and mitigates the potential impact of funds choosing unsustainable, short term strategies because they initially generate better returns. The eight year period also prevents funds from shying away from choosing investments that differ from those that constitute the market indexes.

We reiterate our earlier recommendation that APRA act on the Productivity Commission's suggestion that all products are subject to an elevated outcomes tests in order to earn the 'right to remain' in the system. Using the Productivity Commission's recommendation products would fail this test if they underperform relative to their tailored (by asset allocation) benchmark by at least 0.5 percentage points over a rolling an 8 year period.

Without a similar set of benchmarks in place underperforming funds will be given far too much latitude to define their own success, ultimately leading to consumer harm. We support the Productivity Commission's conclusion that a benchmark should be fully implemented by 2022. By this point, APRA will have collected eight years of high quality MySuper data and should be well on its way to collecting a useful choice product dataset.

*Recommendation 6: that APRA include a 'right to remain' threshold test in the regulatory architecture, such as underperformance relative to their tailored benchmark by at least 0.5 percentage points over an eight year period.*

### **7. Consequence for serial underperformance**

We reiterate our concern, conclusively demonstrated by the Productivity Commission's recommendation for a new elevated outcomes test, that funds are setting - and the risk that they will continue to set - low benchmark performance targets that are easily met and do not necessarily deliver a good retirement income for people.

Only objective benchmarks, including peer group comparison and tailored benchmark portfolios constructed in a standardised manner in accordance with guidance from APRA (to avoid funds gaming the system), will force funds to make objective assessments of their risk and returns. A product underperforming both its competition and a passive index version of itself is unlikely to be promoting members' financial interests, even when distortions of short run market volatility are considered.

We reiterate our earlier recommendation that APRA require underperforming funds to rectify their shortcomings within one year of receiving notice or face revocation of their MySuper license or direction to withdraw the underperforming choice investment option. This warning could be included in SPG 516 after paragraph 25.

*Recommendation 7: that APRA amend SPG 516 to state that underperforming funds will be required to rectify their shortcomings within one year of receiving notice or face revocation of their MySuper license or direction to withdraw the underperforming choice investment option.*

## **8. Insurance cohort analysis**

SPG 516 paragraphs 15 to 22 provide guidance on conducting cohort analysis, but miss at least two important considerations. When determining whether their insurance product is delivering appropriate benefits, funds should categorise their membership by whether they have dependents or intermittent work patterns. Both of these factors have significant impact on the value of insurance offerings.

Many of the problems identified by the 'Putting Members Interests First' legislation could have been addressed if trustees had been conducting proper cohort analysis when designing insurance products. The legislated changes still do not address all examples of junk insurance products for some cohorts, such as those in casual, intermittent employment. In many cases these people would be unable to make an income protection claim due to exclusions in the fine print, such as work eligibility tests.

We maintain that trustees will not properly design and structure insurance products or properly inform members about their value without explicit direction in the Practice Guide to consider these cohorts.

We also note SPG 516 paragraphs 36-37 on insurance benchmarking implies that there is limited insurance data available to conduct comparisons - but does not make a connection to cohort analysis.

We strongly recommend that APRA improve the guidance provided in SPG 516 to require BPRs to conduct a cohort analysis to review the suitability of each type of insurance cover and product design. This should include, but not be limited to, demographic factors such as gender, income, balance size, those in intermittent or casual work, and number and age of dependents.

The nature of the way insurance should be considered in the Prudential Standard has also changed.

An earlier version of SPS 515 (December 2018) provided limited guidance, including the explicit consideration of '*the insured benefits available to beneficiaries, relative to the cost of those insured benefits*' at paragraph 17(e)(iii). This obviously implies a cost/benefit analysis.

However, this section was replaced in successor versions, with a reference to s52(9) of the SIS Act at (new) paragraph 21, which refers to existing legislated measures in s52(11)(e): '*whether the insurance strategy for the product is appropriate to those beneficiaries*'; and '*whether any insurance fees charged in relation to the product inappropriately erode the retirement income of those beneficiaries.*' This closed question removes the earlier implied cost/benefit analysis.

We note the Productivity Commission was particularly critical of the poor value of insurance in superannuation, and reiterate our recommendation, above, that the BPR should be explicitly linked to delivering member outcomes. This requirement could be added to SPG 516 after paragraph 37.

*Recommendation 8: that APRA amend SPG 516 to require conducting a cohort analysis to review the suitability of each type of insurance cover and product design. This should include, but not be limited to, demographic factors such as age, gender, income, balance size, those in intermittent or casual work, and number and age of dependents.*

### **9. Member services survey**

The introduction of an annual BPR presents a significant opportunity to introduce a standardised representative survey of fund members, to assess their understanding of the characteristics of their superannuation products, and the available benefits and services.

Standard metrics would assist both regulators and funds to assess their respective performance, provide a recurring prompt for members to engage with their superannuation, and guidance on areas needing improvement or further education.

In addition, collecting key demographic information about their membership would have great value for funds, regulators and other stakeholders interested in ensuring their products are suitable for their membership. The data could both inform the outcomes assessment and be reported directly to APRA to provide comparisons between funds.

We reiterate our earlier recommendation that APRA mandate the design and implementation of a compulsory, standardised representative annual survey of fund members, to assess levels of awareness and understanding of superannuation product features. This requirement could be added to SPG 516 after paragraphs 81-83.

*Recommendation 9: that APRA amend SPG 516 to mandate the design and implementation of a compulsory, standardised representative annual survey of fund members, to assess levels of awareness and understanding of superannuation product features.*

Yours sincerely,



Xavier O'Halloran  
**Acting Director - Super Consumers Australia**

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