Consultation on Prudential Practice Guide SPG 516 – Business Performance Review

SuperRatings' Submission

October 2019

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1. Introduction

SuperRatings would like to thank APRA for providing us with the opportunity to comment on the proposed revisions to the *Prudential Practice Guide SPG 516 – Business Performance Review* (**SPG 516**) which provides guidance in relation to *Prudential Standard SPS 515 – Strategic Planning and Member Outcomes* (**SPS 515**).

SuperRatings is a research and consulting firm, which has been assessing and rating superannuation funds and products for more than 15 years. We are therefore well placed to comment on the development of the member outcomes assessment framework.

SuperRatings strongly supports the intent of SPS 515 and APRA introducing measures to improve transparency in the superannuation industry and to ensure superannuation funds are well-run entities that serve members' best interests. Our business mission is to close the information divide between funds and their members and create a stronger superannuation industry that benefits all Australians. We believe SPS 515 goes a long way towards contributing to this goal.

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2. Comments on SPG 516

2.1. Distinguishing the different types of outcomes assessments

Under SPS 515 para 15(a) (and SPG 516 para 11(a)), the business performance review (**BPR**) needs to have regard to performance analyses in three components, all involving some form of outcomes analysis. This includes the monitoring of the business plan, which involves determining if business initiatives or significant expenditures have achieved their stated outcomes.

The current draft SPG 516 seems to distinguish the different types of outcomes assessments by:

- referring to the outcomes assessment under SPS 515 para 15(a)(ii) as "cohort analysis", and
- referring to the outcomes assessment required under section 52(9) of the SIS Act as either "annual outcomes assessment" or simply "outcomes assessment".

For example, SPG 516 para 16 states that "[assessing] the RSE licensee's performance at a cohort level is intended to complement the annual outcomes assessment", and para 46 states that "investment strategy may be relevant to only the cohort analysis and the outcomes assessment".

We suggest that rather than using the term "cohort analysis" (which is not a defined term) it would be clearer to use "cohort-based outcomes assessment" where referencing the requirement under SPS 515 para 15(a)(ii). Additionally, the term "SIS outcomes assessment" could be used instead of "annual outcomes assessment" or "outcomes assessment" to indicate where SPG 516 is providing guidance in relation to the SIS Act requirements.

To further improve clarity, these two terms could be defined in either the "Introduction" or "About this guide" section to explain how SPG 516 uses these two terms, so that readers are aware of the differences at the outset. By defining these two terms, it would also help readers distinguish where SPG 516 is using the term "outcomes" in a general sense and not referring to specific legislative or prudential requirements.

We note that it may be necessary to also make these minor changes to SPS 515 and *Prudential Practice Guide SPG 515 – Strategic and Business Planning* (SPG 515) to ensure consistency in terminology used in these documents.

In our submission below we have used our suggested terms to distinguish the different types of outcomes assessments.

2.2. Timing considerations

SPG 516 outlines APRA's timing expectations on funds completing their BPRs. APRA expects funds to complete the SIS outcomes assessment component of the BPR by the next February for the preceding July-June financial year and the remaining two components of the BPR by the next May for an updated business plan to commence on 1 July.

Furthermore, SPS 515 (in footnote 6) provides that "[for] the purposes of undertaking the first business performance review by 31 December 2020 an RSE licence is not required to have regard to the outcomes assessments under section 52(9) of the SIS Act".

APRA's letter to trustees dated 28 August 2019 on "Response to submissions – proposed revisions to SPS 515" ("APRA Response to Submissions") provided some background to APRA's thinking. APRA has revised its timing expectations in recognition that many funds currently undertake their strategic planning cycle in March-May each year. This means for 2020, APRA is expecting funds to undertake their BPR, excluding the SIS outcomes assessment component in the first half of the 2020 calendar year. The first full BPR including the SIS outcomes assessment will be in the first half of the 2021 calendar year.

Previously APRA indicated (as part of the "frequently asked questions" on its website) that it expected the first BPR to be with respect to the 2019/2020 financial year and would need to be completed by 31 December 2020. This effectively meant that the first BPR would be performed in the second half of the 2020 calendar year.

We recognise that the revised timing expectations will align better with many funds' strategic planning cycles; however we have two concerns.

Retrospective application of SPS 515 requirements to 2018/2019 business plan

The first BPR now expected to be undertaken around March to May 2020 can only be with respect to fund performance in the 2018/2019 financial year. Funds' strategic objectives and business plan for 2018/2019 would most likely have been put in place prior to July

2018, before APRA finalised SPS 515's requirements in relation to strategic and business planning in December 2018.

Therefore, it is unlikely that funds' business planning for 2018/2019 would have articulated member outcomes, cohorts or the financial projections and metrics that are now required as part of SPS 515. Asking funds to perform their first BPR with respect to the 2018/2019 financial year is, in effect, retrospectively applying SPS 515 requirements to financial years prior to SPS 515 being finalised.

We understand that APRA considers the BPR to be a process of continual improvement and that during 2020 APRA is looking for "reasonable efforts" by funds in conducting their first BPR (as stated in the APRA Response to Submissions). We would still question the utility of performing a BPR with respect to 2018/2019. While it may help funds identify any gaps in their business planning and BPR processes, this will not have an impact on the 2019/2020 business plans, which should already be in place.

We suggest requiring funds' first BPR to be with respect to the 2019/2020 financial year, as by the time 2019/2020 business plans were put in place funds would have had a year's notice of SPS 515's requirements. Therefore, it would be more reasonable to expect funds' business plans to accommodate at least some requirements of SPS 515. This would mean that the first BPR cannot be started until after 1 July 2020; however we think it would be more efficient for funds to focus their efforts in the first half of 2020 on putting in place frameworks and processes to implement SPS 515. This could involve a trial run of the BPR with respect to the 2018/2019 financial year if a fund chooses to do so.

We also suggest that compared to undertaking a BPR excluding the SIS outcomes assessment, it is more feasible for funds to perform the SIS outcomes assessment (with the relevant SIS regulation carve-outs – see comments in section 2.3) with respect to their performance in the 2018/2019 financial year in the first half of the 2020 calendar year. The SIS requirements can be seen as a less expansive assessment or a subset of the cohort-based outcomes assessment where cohorts and key metrics are specified by the SIS Act. In this sense the SIS outcomes assessment is relatively speaking better defined, allowing less discretion and requiring less process design on the part of the funds. Therefore, we suggest that the funds should attempt to undertake the SIS outcomes assessment as a precursor to the full cohort-based outcomes assessment.

Timing of publishing SIS outcomes assessments

APRA's timing expectations in SPG 516 are also influenced by when industry statistics become available. Currently, APRA publishes annual fund statistics for the year ending 30 June in December, while MySuper data are published on a quarterly basis.

While we recognise the current limitations due to data timing, we consider that, in the longer term and after a few iterations of outcomes assessments, it would be reasonable for members to expect more prompt publishing of summary results of the SIS outcomes assessment than eight to nine months after the financial year end.

We understand that APRA is commencing consultation on enhancements to superannuation reporting collection later in 2019. And this may impact on data collection and availability in the longer term. Therefore, we would suggest that in outlining timing expectations in SPG 516 it would be desirable for APRA to provide a longer-term roadmap for the industry.

APRA could do so by introducing a transition period, which for now could be flexible depending on data collection enhancements and when SIS regulations on outcomes assessment are finalised. We suggest that APRA could comment in SPG 516 on its views as to whether there is scope in the future to shorten the eight-month plus timeframe for publishing SIS outcomes assessments and performing BPRs. This would help manage expectations and allow trustees to plan for future changes.

2.3. SIS outcomes assessment carve-outs

SPG 516 para 75 states that, in relation to choice products, due to SIS regulations not being finalised, funds are not able to undertake the comparison requirements "under sections 52(9)(a)(ii) and 52(10A) of the SIS Act", however funds are still required to undertake an assessment under section 52(9)(a) based on the assessment factors under section 52(11).

We have a different interpretation of the SIS Act wording and the consequences of not having the relevant SIS regulations.

We note that the phrase "benchmarks specified in [the SIS] regulations" appears three times in sections 52(9) to 52(11) of the SIS Act on annual outcomes assessment and not all in relation to choice products. The phrase appears in:

- section 52(9)(a)(i) in relation to comparison of MySuper products;
- section 52(9)(a)(ii) in relation to comparison of choice products, and
- section 52(9)(aa) in relation to promoting the financial interests of the beneficiaries of the fund overall.

The specific wording in section 52(9)(a)(ii) is:

> *If the product is a choice product – a comparison of the choice product with the comparable choice products in relation to the choice product, based on factors mentioned in subsection (10A), <u>and a comparison of the choice product with any other benchmarks specified in regulations made for the purposes of this subparagraph.</u>*

Our interpretation of the above wording is that the comparisons of a choice product to comparable choice products and to SIS regulation benchmarks are separate comparisons. Therefore, there is arguably no need to carve out the comparison required under section 52(9)(a)(ii) as relating to factors under section 52(10A).

Conversely, it could be argued that as similar wording (to those underlined above) applies to MySuper products in section 52(9)(a)(i), if section 52(10A) is carved out, then similarly section 52(10) should be carved out too.

Therefore, until the SIS regulations are finalised, we think it is only necessary to carve out the requirements under sections 52(9)(a)(i) and 52(9)(a)(ii) in so far as related to comparisons to benchmarks specified in SIS regulations and section 52(9)(aa). Assessment in relation to choice products using factors under section 52(10A) should be retained.

We also note that funds will need to analyse and compare investment performance and fees for choice products as part of cohort-based outcomes assessments, even if section 52(10A) is carved out from the SIS outcomes assessment until SIS regulations are finalised.
If APRA has other considerations in relation to carving out of SIS sections 52(9)(a)(ii) and 52(10A), but retaining sections 52(9)(a)(i) and 52(10) despite the similar wordings of these sections, we would suggest that APRA explain these reasonings as part of the SPG 516.

2.4. Structure of SPG 516

The current SPG 516 sets out APRA's expectations in relation to the cohort-based and SIS outcomes assessments in separate sections. This means that guidance on the same product or areas of assessment are covered in various parts of SPG 516, for example:

- For MySuper products, guidance is covered in paras 17, 26-27, 33-35, 64, 67-74, 88;
- For choice products, guidance is covered in paras 18, 27, 32, 75-77, 84;
- For insurance, guidance is covered in paras 26, 36-37, 90-94, and
- For fees and costs, 21, 26, 29, 33-35, 97-103.

This structure does not make it easy for the reader to compare the differences in APRA's expectations on assessment of the same product/area. We think it also makes the SPG 516 repetitive at times.

We also note that guidance for the SIS outcomes assessment is provided after the section titled "Business performance review results". This is likely to be due to the section on the SIS outcomes assessment being appended to the original draft SPG 516 after the SIS Act outcomes assessment sections passed by the Parliament. However, the SIS outcomes assessment is an input to the BPR and should precede discussions in SPG 516 on determining BPR results and taking action.

As stated earlier, we think the SIS outcomes assessment can be seen as a less expansive assessment or a subset of the cohort-based outcomes assessment (where cohorts and metrics are defined by the SIS Act). We therefore suggest that SPG 516 could be structured to group guidance together based on product or area for assessment (which would be MySuper, choice products, insurance, and other areas such as options, benefits and facilities). This would make it easier for readers to ascertain what different items need to be covered under the two types of outcomes assessments for each area of assessment.

There will necessarily be areas that are relevant to one type of outcomes assessment but not the other, for example, publishing a summary of results is only relevant to the SIS outcomes assessment, and defined benefit products are only relevant to a cohort-based assessment.

2.5. Guidance in relation to SIS Act section 52(11)

The current wording of SIS Act section 52(11) is such that funds need to perform assessment "for the product" on insurance, investment strategy and options, benefits and facilities. It implies that these assessments need to be performed separately for MySuper and choice products. This is not workable in practice due to the SIS Act's definition of a "choice product".

The SIS Act defines the term "choice product" by what it is not, it is not MySuper interests or interests only available to be held by defined benefit members. The exact wording of the definition is:

> *"choice product" : A class of beneficial interest in a regulated superannuation fund is a choice product unless:*
> *(a) all the members of the fund who hold that class of beneficial interest in the fund are defined benefit members; or*
> *(b) that class of beneficial interest in the fund is a MySuper product.*

This definition creates various issues for the outcomes assessment.

Firstly, a choice product, based on a strict reading of its SIS definition, could be interpreted to be a single product that covers all member investment choice options and also retirement income products. It is not immediately clear if the SIS Act definition allows different choice products to exist in a fund and how to distinguish the different choice products or class of interests. APRA recognises this issue in SPG 516 para 84 in stating that funds "may not have an investment strategy for the relevant choice product" as investment strategies are set at either investment option level or for the whole fund.

The wording of SIS Act section 52(9)(a)(ii) and 52(10A) seems to indicate that as far as a SIS outcomes assessment is concerned, a fund may have different choice products based on different member investment choice options, hence funds need to determine comparable choice products.

Secondly the definition of a choice product is not helpful when insurance is concerned. Funds' insurance designs distinguish default/automatic insurance members and members who have exercised choice in relation to insurance. However the insurance designs do not differ across MySuper and choice products. For example,

- A member who has tailored insurance would still be considered a MySuper member if the member has not exercised investment choice.
- A member could hold MySuper and choice products concurrently but the member's insurance policy with the fund would not be considered to be specifically relating to either the MySuper or the choice product.
- We also note that in the cases of master trusts, various default insurance designs could apply to different employer funds despite the fact that the fund is licensed to offer a single MySuper product. This further illustrates that a fund's insurance arrangements are not MySuper or choice product related.

Similarly, funds do not necessarily offer different services or options, benefits and facilities for MySuper and choice products. And it would be repetitive if funds need to perform assessment in these areas for each of their MySuper and choice products.

We would suggest that as part of SPG 516, it would be desirable for APRA to give more pragmatic instructions in relation to how to implement SIS Act section 52(11). Specifically, funds should be able to undertake assessment under this section starting at a fund level and only proceed to address product level considerations where the areas of assessment differ by product. We believe this is a more logical approach than APRA's current guidance, in particular:

- in SPG 516 paras 81 to 83 on "Options, benefits and facilities" which suggest that funds should start with product-based analysis and extend to fund-level services where relevant
- in SPG 516 paras 90 to 94 on "Insurance strategy and insurance fees" which includes statements that suggest insurance arrangements vary between MySuper and choice products. Para 92 states that "the insurance strategy may allow for different default insurance product settings for members holding a MySuper product" which is not generally the case for superannuation funds.

2.6. Other comments on SPG 516

Net returns and net investment returns

Throughout SPG 516, APRA has used the term "net returns" mostly. The term "net investment returns" is used only once in para 32 in relation to benchmarking to non-superannuation investment products.

The SIS outcomes assessment seems to envisage different returns to be used for MySuper and choice product assessments, requiring net returns to be used for MySuper products, but is less prescriptive in relation to choice products:

- Section 52(10)(b) provides that the trustees must compare "the return for the MySuper products (after the deduction of fees, costs and taxes)", and
- Section 52(10A)(b) provides the trustees must compare "the return for the choice products".

It would be useful for the industry if APRA could provide its thoughts on this distinction made in the SIS Act and how it would affect the outcomes assessment.

In relation to investment benchmarking, SPG 516 indicates that APRA expects net returns to be used, in addition to considering the investment fees and costs incurred and investment risks to generate the returns (see paras 29 and 86). It is not quite clear if and how administration fees are to be captured in these analyses.

Historical returns and comparison of returns over longer time periods

SPG 516 para 74 states that, for MySuper products, funds should utilise the representative member investment performance for the time period the product has existed (up to 10 years) against all other MySuper products with that history.

The returns for a representative member (with a $50,000 balance) over one year are currently worked out to be net returns after asset-based (i.e. percentage) fees (both investment and administration) and flat fees (generally fixed annual administration or membership fees). While these data are available for each one-year period, performing analysis across multi-year time periods would be affected by how the representative member's balance increased over the years and how flat fees would then have a different percentage impact on member balances.

We would suggest that to perform analysis of performance across multiple time periods, it would be easier to compare compounded returns after all asset-based fees but before any flat membership fees. There is not a need to use a representative member in this case. While historically flat membership fees were more varied across the industry, in recent years they have been converging and hence would have a smaller impact on a returns comparison.

Our comments above would also apply to any choice product performance comparison across multiple time periods. For choice products, it would also be useful for the industry if APRA could provide some guidance on the time periods over which funds need to compare performance (similar to APRA's guidance for MySuper products in para 74).

Operating costs

SPG 516 para 97 states that "operating costs include administration costs, investment costs and management costs". We do not believe operating costs should include any investment costs. In funds' financial statements operating costs are disclosed separately to investment costs. Alternatively, two sets of analyses could be performed for operating costs excluding investment costs and inclusive of investment costs.

Fund level assessment under SIS section 52(9)(aa)

The current SPG 516 does not mention SIS section 52(9)(aa) and APRA's expectations in relation to this aspect. We expect that this is due to the lack of relevant SIS regulations and APRA would provide updated guidance once SIS regulations are finalised. If this is the case, we would still suggest APRA to include commentaries to such effect in SPG 516 for completeness.

3. Comments on SPG 515 and risk-adjusted returns

In the latest versions of SPG 515 and SPG 516, APRA moved the section on "Articulating member outcomes" from SPG 516 to SPG 515. This section states that APRA expects trustees to articulate outcomes in relation to "risk-adjusted investment returns", it does not mention any other investment returns measures. We suggest that trustees need to articulate outcomes in relation to both investment returns and risk-adjusted investment returns.

Further guidance on measures of "risk-adjusted" returns from APRA would be helpful. For example,

- Are calculations for specific risk-adjusted return measures (such as Sharpe ratios) required?
- Or perhaps APRA is envisaging that returns should be presented against their risk level, for example, in charts of returns relative to risk levels?

Specific risk-adjusted return measures can be confusing for members to understand and interpret, and this makes it even more important to have an industry standard practice and regulatory guidance on risk-adjusted returns.

4. About SuperRatings

SuperRatings is a superannuation research and consulting company providing data analysis, information, bespoke services and product benchmarking to the superannuation industry, corporate sector and the general public. SuperRatings prides itself on providing impartial advice to funds and employers, therefore our ratings methodology includes all superannuation funds and we limit the ratings percentile bands of funds to ensure our assessment remains independent. We actively promote engagement, education and ownership of superannuation through the provision of:

- Research analysis;
- Ratings;
- Consultancy services;
- Product reviews;
- Benchmarking; and
- Opinion.

Since its inception, SuperRatings has comprehensively reviewed hundreds of Australia's largest superannuation funds and service providers. SuperRatings currently maintains detailed information in respect of 622 superannuation products, incorporating 113 MySuper products, 327 choice products and 182 pension products as well as 70,000 insurance product lines of premiums which are all housed within our in-house proprietary database, SMART.

We believe we offer the most extensive industry coverage accounting for over $1.5 trillion in funds under management and over 28 million member accounts. This allows us to understand the various costs, fees, products, services and performance of superannuation funds and benchmark these against the broader market.