



**Submission in response to
'Strengthening superannuation member outcomes'
discussion paper**

March 2018

1. Submission participants

This submission is made by:

- Independent Fund Administrators & Advisers Pty Ltd (IFAA), a Brisbane based administrator of industry superannuation funds and managed investment schemes;
- QIEC Super – a profit for members industry fund, established specifically for the benefit of all participants in the non-Government education sector, child and other care and community services in Queensland;
- Club Super - a profit for members industry fund, established specifically for the benefit of employees in the sporting and recreational clubs and associated industries in Queensland.

2. Executive summary

As we indicated in a previous submission on the accountability and member outcomes proposals, we recognise and support the need for appropriate regulation of the superannuation industry, and for Funds to be delivering appropriate outcomes for members. However, as outlined below, we have a number of concerns with the proposals flagged in the discussion paper, and the broader change agenda, including:

- the fact there is currently an array of proposed legislative changes before Parliament, along with numerous inquiries, reviews, the Royal Commission, and further proposals for regulatory change. It is not at all clear that there is a co-ordinated and harmonised approach from Government and regulators to these multiple components of regulatory policy. Additionally, previous changes are barely given time to take effect before the next round of significant changes are introduced;
- the proposed application of expense management requirements across the entire industry. Where concerns have been identified with particular Funds, we believe APRA should direct regulatory attention at those Funds. Application of these rules to those Funds who have no related party transactions and are scrupulous about the governance of expense management would simply add unnecessary work and cost, for little or no gain;
- a number of the current proposals, including expense management, outcomes assessment and business planning are moving away from principle based regulation to detailed prescription. This will reduce the scope for flexibility and result in additional cost, which is ultimately borne by members;
- a view that the Government should only further regulate where market evidence justifies it, or where there are clear benefits to the community. For each new regulatory proposal, greater consideration should be given as to whether the cost outweighs the benefits. We suspect that will be the case if the expense management requirements are applied broadly, and this will represent an adverse 'member outcome', contrary to the objectives of the current proposals;
- that costs are growing with the ever increasing scope of regulation, including direct compliance costs, greater Board time devoted to regulatory and compliance matters, project and implementation costs, additional staff tasks, additional training as well as system configuration costs. At the same time, the Government questions why fees and costs are not falling across the industry. We believe the Government should be aware of the risk of over regulation, and the cost impacts, which are ultimately borne by members.

These concerns are expanded upon in the remainder of the submission.

3. Co-ordination of multiple proposals

It is noted that:

- the associated *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017* has not passed as of the date of this submission;
- the Productivity Commission inquiry into the competitiveness and efficiency of the superannuation industry is yet to be handed down. This has potentially very significant implications for the default fund system and the structure of the industry;
- the Royal Commission into the banking, superannuation and financial services industries is underway and may also result in future regulatory changes;
- implementation of the RG97 fee and cost disclosure regime is currently subject to review;
- proposed 'design and distribution' obligations would have potentially significant impacts on Funds by requiring them to conduct a formal target market determination across all financial products they offer;
- Single Touch Payroll is due to be rolled out soon and may have significant implications for how members choose their fund.

In relation to prior regulatory changes, we consider that the Government should allow time for the various initiatives to take effect, and to actually measure the outcomes and impact on the industry and members, before embarking on the next round of significant changes. In relation to the range of current proposals and inquiries, there should be much greater co-ordination to ensure the various changes work in unison and do not conflict or duplicate other proposals. It is not at all clear that there is a holistic outlook to ensure the various proposals integrate seamlessly.

4. Legislative issues

The paper indicates that APRA will monitor the progress of the above Bill in formulating the final Prudential Standards. We consider it would be inappropriate for APRA to proceed with the proposals in the absence of the Bill being passed by Parliament.

5. Fund expenditure proposals

The paper indicates that APRA has identified an apparent need for improvement in relation to governance and oversight of related party transactions. We strongly assert that it is simply not the case that there are widespread problems with expense management that would justify the entire industry being subjected to extensive new requirements.

SPS 220 proposes to require Trustees to have in place an Expenditure Policy to ensure Fund expenditure is consistent with its strategic objectives and to require Trustees to demonstrate how expenditure is linked to the delivery of cost effective, positive member outcomes. It also requires the preparation of a detailed business case for all significant fund expenditure, which is to address a prescriptive list of requirements.

As Trustees are already required to ensure all decisions are made in the best interests of beneficiaries, these proposals can only be of benefit where concerns exist about the manner in which Fund moneys are being expended, particularly where related party transactions exist. Neither QIEC Super or Club Super has any related parties, with all service providers engaged at arms length and fund expenditure decisions subject to appropriate governance and oversight. In these circumstances, there would clearly be cost associated with compliance, but little or no benefit either to members, the Funds or the system as a whole.

The proposals also extend to 'look through' reporting of Fund expenditure, which would require Trustees to obtain information from third parties and report to APRA as to how the monies were expended. As above, we consider that such obligations should be restricted to those Funds for whom concerns have been identified. Alternatively, we strongly recommend that these proposals apply only to 'associated entity' transactions. If APRA were to define associated entity broadly, this would have significant and unwarranted implications for QIEC Super and Club Super, in that new data would need to be collected and reported to APRA. It may also raise complications in Fund contracts and relationships with service providers.

We believe that the proposed application of both the general expense management proposals and the look through proposals across the entire industry is inappropriate, and for Funds such as QIEC Super and Club Super, will deliver an adverse member outcome, as we expect costs will outweigh benefits. Any concerns identified by APRA should be addressed through targeted supervisory activity directed at the relevant Funds.

It is noted that in the course of prior prudential reviews, APRA has not raised expense management as an issue for either QIEC Super or Club Super. Trustees of both Funds are diligent in their management of expenses and in executing their responsibilities under s.52 and s.52A of the *Superannuation Industry (Supervision) Act 1993 (SIS)*, which, inter alia, requires them to make decisions in the best interests of beneficiaries and to apply the same degree of care, skill and diligence as a prudent superannuation trustee.

It is also noted that the paper references feedback received from prior consultation (section 1.6) and a previous request from industry for APRA to address any concerns through supervisory activity. This package of proposed reforms indicates this feedback has not been taken on board. **We request that the proposed application of these requirements across the industry be reconsidered.**

6. Member Outcomes

We note that the requirements of the outcomes test will be contained in SIS (if the Bill is passed) and in SPS 225. Trustees will need to comply with both sets of requirements, which seems unnecessarily complex. It is also noted that the outcomes test is to be applied to all members, not just MySuper members.

We provided commentary in a prior submission that the outcomes test should have regard to both qualitative and quantitative factors, which would be consistent with the position set out in APRA Insight, issues 1 and 2 of 2017. The provisions in the draft Bill focus on quantitative outcomes and the promotion of members' financial interests. However, we are pleased to also see recognition of qualitative factors in SPG 225.

Draft SPG 225 outlines some possible outcomes that Trustees may seek to achieve, including reducing administration and operating costs. As outlined above, the ever increasing scope and cost of regulation makes this less and less likely.

Draft SPG 225 also sets out APRA's expectations about utilisation of an extensive range of metrics and benchmarking internal Fund results on an absolute basis, but also benchmarking against nominated other Funds on a relative basis. APRA also expects justification about how the selection of metrics and comparison funds enables objective assessment. SPG 225 suggests selection of peer funds across the industry, not limited to peers based on size, sector type or profit status.

In the absence of clear regulator guidance, different Funds will conduct the test in different ways, thereby minimising the comparability of results. For example, draft SPG 225 does not provide clear guidance on how extensive the peer comparison should be.

Draft SPG 225 also expects Trustees to analyse the results of the comparison against peer funds and determine which elements of the Fund offering are the cause of any underperformance. Any potential improvement in member outcomes must be considered, and if warranted on a cost / benefit basis, incorporated into the next business planning process.

APRA has also indicated that in relation to the investment offering, Trustees should set thresholds beyond which certain investment options would be considered unviable. This is already happening in practice. For example, Club Super resolved to close two of its investment options in 2017. Further, APRA expects consideration of return objectives, risk profiles and liquidity requirements across the offering of investment options. Again, QIEC Super and Club Super are already giving effect to these expectations.

In relation to the insurance offering, draft SPG 225 outlines an expectation for Trustees to thoroughly assess their product and conclude that it is not inappropriately eroding member benefits.

It is evident that once the requirements of SIS and SPS 225 are considered, the scope of the proposed member outcomes test is extensive. It will be a major exercise for Trustees to complete this assessment annually, addressing all relevant considerations. We believe it will be particularly challenging to gather meaningful peer data upon which comparisons could be made. It is not clear that all required data and metrics relating to other Funds would be publicly available.

We are also concerned that the proposed outcomes requirements addressed in draft SPS 225 are moving away from principles based regulation to detailed explicit prescription. This reduces scope for flexibility in complying, and will add to costs for Funds and ultimately members.

The paper indicates (p17) that the Government proposes to replace the existing scale test with the proposed outcome assessment addressed in draft Prudential Standard 225. However, draft SPG 225 (Outcomes Assessment) outlines (paras 4 & 42) that SPS 225 enables Trustees to incorporate the scale assessment conducted under s.29VN of SIS, to satisfy the outcomes assessment required under SPS 225. There is no such reference contained in draft SPS 225. This is also confusing as it seems to contemplate the scale test and the outcomes test continuing as separate requirements, operating in parallel. These matters require clarification.

Draft SPG 225 outlines that where Funds consistently underperform in relation to member outcomes, whether on an absolute and/or relative basis, APRA expects Trustees to consider the future operation of the Fund. We consider that based on the differing strategic objectives of various Funds, the 'member outcomes' being sought may well be very different, making meaningful comparison difficult in some circumstances.

7. Strategic and business planning

The goals underlying the proposals to enhance the business and strategic planning process are sound. However, as with the member outcomes proposals, we are concerned that the strategic and business planning proposals are moving away from principles based regulation to detailed explicit prescription. This reduces scope for flexibility in complying, and will add to costs for Funds and ultimately members.

8. Proposed reporting changes

The paper indicates that APRA is proposing reporting changes to improve supervisory, industry and public understanding of Fund and Trustee expenditure. We suggest that in the interests of transparency, any public reporting also disclose the significant and growing proportion that compliance costs represent as a portion of total costs of superannuation funds.

We outlined in section 4 of this submission our concerns with the 'look through' proposals, and how we consider they should be applied. As with the concerns raised about the general expense management proposals, in the scenario where QIEC Super and Club Super have no associates, and all transactions with service providers are conducted at arms length, application of the 'look through' proposals would come at cost, but with little or no corresponding benefit. This would deliver an adverse member outcome. We request that if implemented, 'look through' requirements apply only to associated party transactions (ie. common ownership in part or full), and we request APRA provide guidance on the definition of 'associate' accordingly. Alternatively, we request that these proposals are only applied to specific Funds upon request from APRA.

The paper indicates that post AASB 1056, APRA expects the quality of expense information will be improved by the addition of new categories of reporting and enhanced clarity around the extent of Trustee discretion when categorising fund expenses. We question that, as in our experience, the reporting of expenses is substantively unchanged post AASB 1056. As a result, we consider it would be incorrect for APRA to assume that Funds have already made the necessary changes in expense reporting and that these expense reporting proposals would not represent much of an additional burden.

We are also very concerned about the stated intention to gather expense data for MySuper products with the same granularity as Fund level data. Accounting systems are not currently designed to track expenses at investment option level. If this becomes a requirement, this would require wholesale changes to our accounting systems, with associated cost implications.

9. Management of reserves

Draft SPG 221 also sets out APRA's expectations regarding management of reserves. These proposals are consistent with current guidance, and are generally supported. Draft SPG 221 outlines that reserves are typically held to address contingent events.

10. Simplifying insurance opt-out

The paper confirms the Government's intention to make it easier for members to opt-out of default life and disability insurance cover, within superannuation. The paper sets out APRA's intention to

modify SPS 250 – Insurance in Superannuation to require Trustees to provide simple and straightforward opt-out process for all insurance products.

QIEC Super and Club Super already have relatively simple insurance opt-out processes. However, it is intended to further enhance the opt-out choices available to members, including via the Member Online facility. As a result, we have no objection to this proposal.

11. Cost of compliance

The consultation paper requested that Funds use a Government tool to submit detailed cost impacts associated with complying with the new proposals. The proposals clearly represent a significant amount of additional work that would need to be conducted, which would come at additional cost to Funds, and ultimately members. However, to try and itemise and cost each component of the additional work at this time would be a major exercise in itself.

For small Funds such as QIEC Super and Club Super, this task would also come at additional cost to the Fund and members. For this reason, we do not propose to conduct this exercise at this time, but we reiterate that the proposals will represent significant additional work and cost which will need to be borne by the Funds and ultimately their members.

The consultation paper advises that in seeking to minimise the additional compliance burden, APRA is incorporating enhanced requirements in relation to strategic and business planning and expense management into existing SPS 220 (Risk Management), rather than creating a new Prudential Standard. It is not clear how this reduces the compliance burden, as the content still represents significant new requirements.