29 March 2018

STRENGTHENING SUPERANNUATION MEMBER OUTCOMES

General Manager, Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority

BY EMAIL: superannuation.policy@apra.gov.au

Dear Ms Richards,

The Financial Services Council welcomes the opportunity to make a submission in response to APRA's *Strengthening superannuation member outcomes* discussion paper (the discussion paper).

The Financial Services Council (FSC) has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than $2.7 trillion on behalf of 13 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world.

The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

The FSC shares APRA's goal of ensuring positive outcomes for fund members. However, additional consideration of the measurement and reporting requirements proposed is needed in order for them to deliver meaningful information that promotes improved member outcomes.

Please find our detailed submission below. We look forward to working with APRA to refine these proposals.

Should you wish to discuss this submission further please do not hesitate to contact me on (02) 9299 3022.

Yours sincerely,

Jane Macnamara
Policy Manager, Superannuation and Investment

STRENGTHENING SUPERANNUATION MEMBER OUTCOMES SUBMISSION

INTRODUCTION

The FSC is supportive of initiatives that focus on improving member outcomes in superannuation.

The proposed changes to prudential requirements included in this package are intended to complement and support APRA's focus on "how RSE licensees are prioritising the quality and value of products and services they deliver to members."

While we support the goal of these changes, FSC members have some concerns about their ability to comply with the requirements as drafted, and provide information that will meaningfully reflect member outcomes.

In their current form, the proposed changes present issues in terms of:

- feasibility of providing certain information;
- availability and comparability of peer benchmarking data;
- lack of clarity around reporting requirements; and,
- short implementation timeframes.

In order to achieve the stated goals of these changes, APRA will need to provide additional clarity around the requirements for measurement and reporting, and ensure that requirements are compatible with the business models of all RSE licensees.

The FSC is committed to working with APRA to ensure an effective member outcomes framework can be implemented.

AMENDMENTS TO *PRUDENTIAL STANDARD SPS 220 RISK MANAGEMENT*

Proposals relating to strategic and business planning

We agree that it is important that business objectives and activities are considered in terms of their impact on member outcomes.

However, the proposed amendments to SPS 220 in relation to strategic and business planning appear to create new reporting requirements that may not align with business processes.

In particular, Attachment A of SPS 220 lacks clarity in relation to applicable timeframes around business planning and strategic objectives, which is likely to lead to inconsistent approaches from industry.

Current business planning takes place on rolling 3-5 year cycles. However this horizon is likely to be too short for setting strategic objectives, many of which may be based on initiatives which are implemented within this timeframe but do not translate to member outcomes for a much longer period.

Trustees may also experience challenges where relevant activities are carried out by an outsourced service provider. It is not clear how strategic and business planning requirements would operate in an environment where administration and investment structures are outsourced. In these instances, confidentiality issues often mean the trustee does not have an ability to look through to service providers or have significant control over their commercial decisions, and even where data is available it may not be sufficiently timely to support reporting requirements.

Ultimately, while we strongly support transparency around business strategy and performance, it's important to get the balance right to ensure that each RSE's strategic competitive advantage and intellectual property are protected. These are critical to the long-term success of the fund.

In relation to risk management frameworks, members are also concerned that strategic and operational risks do not fit neatly into the same frameworks, and it may not be practical to implement formal "management information system(s)" for strategic risks. IT systems that can be used for stressing strategic risks (which are by nature future dated risks) are not typical in the market.

While we support the intent of the removal of prescriptive requirements regarding adequate resources by aligning SPS 220 with CPS 220, we note that in practice this is unlikely to actually result in a material reduction in compliance costs for funds if the overall intent of provisions remains unchanged. Particularly in the current environment of enhanced industry scrutiny, is unlikely that RSE licensees would relax current compliance practices in response to this change.

Finally, while the SPS refers to the required content of a business plan, the SPG notes that this does not all have to be in one document. It would be helpful if the SPS could explicitly provide the flexibility to capture details across multiple policies and/or outside the business plan itself (i.e. where requirements are reflected in other documents) rather than in a single document.

RECOMMENDATION: the FSC recommends APRA clarify requirements in in SPS 220 relating to:

- strategic planning requirements;
- management information systems;
- resourcing requirements; and,
- the required format of the business plan for the purposes of the SPS.

Proposals relating to expense management and reserving

The FSC acknowledges APRA's concerns around the need for improved governance and oversight of fund expenditure.

However, the various operating environments for different funds will necessitate a wide range of expenditure and funding practices. For example, there may be periods where competitor pricing has a stronger impact on fee levels than expenditure needs. This will require expenditure policies to be sufficiently flexible to accommodate these kinds of pricing decisions.

It is also not clear what types of expenditure APRA is trying to capture under these requirements. For example, it is not clear whether corporate-related expenses deducted from a fund are expected to be included in the expenditure policy, or what would be considered a "significant" expense.

For the purpose of assessing member outcomes, we consider that "significant" expenses should be limited to expenses that are attributed to an RSE and recovered from members' accounts. Expenses paid at a group level (for example by a parent company), and not attributed to particular RSE or members within a fund, should not be included.

Trustees may also experience difficulty in monitoring the delivery of business case outcomes to support expenditure, particularly where benefits are qualitative or intangible.

RECOMMENDATION: the FSC recommends APRA clarify the requirements in SPS 220 to relate only to expenses deducted from the fund, and provide flexibility for the "expenditure policy" to be comprised of multiple documents. We also recommend that APRA provide further guidance regarding the level and type of expenditure it considers "significant".

PRUDENTIAL PRACTICE GUIDE SPG 221 STRATEGIC AND BUSINESS PLANNING

Contingency planning

Paragraphs 13 and 14 of Draft SPG 221 refer to the need for a fund to include contingency plans for instances when business outcomes are unlikely to be achieved.

The detail required within such a contingency plan, and its appropriateness as part of a strategic plan, requires clarification. We understand that the purpose of this requirement is to ensure a response following consistent periods of strategic underperformance, however the section reads as requiring a detailed plan for the wind up of a fund.

RECOMMENDATION: the FSC recommends APRA revisit the wording of paragraphs 13 and 14 to clarify the intent.

Suggested metrics in Appendix A

As drafted, the insurance related metrics in Appendix A are financial in nature. The insurance industry has for some time been pushing to ensure that measures related to insurance are broader than simply cost. There are a number of additional Membership Indicators that could be included to demonstrate outcomes in relation to insurance. Some of these are similar to other Membership Indicators already suggested which point towards member engagement, such as the percentage of members who switch.

As an example, additional indicators could include:

- the percentage of members who have tailored their insurance design (including opting out of cover); or
- levels of member awareness or understanding of default insurance benefits

RECOMMENDATION: The FSC recommends APRA consider inserting additional, non-financial metrics in the list of examples in Appendix A of SPG 221.

Sole purpose test

The FSC and its members would welcome the opportunity to further discuss the ongoing relevance of *Circular No. III.A.4 The Sole Purpose Test* to ensure guidance is relevant to industry.

PRUDENTIAL STANDARD SPS225 OUTCOMES ASSESSMENT

Peer benchmarking

Paragraph 8 of SPS 225 proposes RSE licensees undertake a relative comparison against other funds. In their current form, the proposed changes are at risk of being undermined by a lack of meaningful, comparable data.

Articulating relative outcomes, particularly on an annual basis, will add significant cost and complexity to the reporting process. Our members foresee significant challenges in setting meaningful targets for relative reporting, and there is a lack of comparable data available across many of the required metrics.

Unless all RSE licensees use the same methodology in completing their assessments, a relative comparison may not produce a meaningful outcome as it will not be comparing like with like. However, given the differences between funds, developing a reporting framework that would enable meaningful relative comparisons would be challenging and costly.

In many cases, reporting relative performance may also be a poor measure of success for some licensees. Reporting against a fund's own targets may provide a clearer picture of whether members are achieving the outcomes that could be expected.

Our specific comments on each the comparison categories are as follows:

- **Investment strategy** – There should be sufficient data to address investment returns and performance comparisons at an annual level if required, assuming consistent methodologies are used in outcomes assessments.
- **Insured benefits** – In our members' experience the usual rate guarantee for insurance is three years, and funds typically review their insurance arrangements when the guarantee period expires. Reviewing insurance arrangements more often than that could be excessive as product offerings do not change frequently. Peer benchmarking exercises, such as ones used for developing a tender, are not cheap and can take months. Annual and peer-benchmarked assessments appear to be excessive in this category. Reviews of insured benefits every three years may be more appropriate.
- **Options, benefits and facilities offered to beneficiaries** – It is unclear how funds would benchmark these services. Funds would typically monitor and assess market developments as they arise. However, significant market developments in these services do not occur frequently. Peer benchmarking at three year intervals may be more appropriate.
- **Scale** – In general, funds do not significantly change in scale on a regular basis. Peer benchmarking of scale every three years is likely to be sufficient, unless there are significant market changes (eg a large number of fund mergers) in the interim.
- **Significant fund expenditure** – Sufficient data is not available to effectively benchmark significant fund expenditures, as funds do not typically share their significant fund expenditures when developing innovations and improvements.

There is also concern among members that annual benchmarking may result in trustees being more wary of taking long-term investment decisions or incurring costs (eg for systems upgrades) for fear of this impacting an Outcomes Assessment.

RECOMMENDATION: we recommend APRA consider a staged approach to implementing this requirement.

In the first instance, APRA should consider whether relative comparisons are appropriate against all metrics (and whether annual comparisons add additional value). APRA should avoid creating standards that lead to funds having to engage external consultants to source data and undertake comparisons.

However, until sufficient data is available to support relative comparisons for a particular category, RSE licensees should be required only to calculate metrics against their own benchmarks and targets.

To support the development of a benchmarking framework, APRA should also seek to ensure consistency between these requirements and the type, frequency and quality of the data it collects and publishes.

The FSC and its members are keen to work with APRA to determine a suitable pathway for implementing outcomes assessment requirements.

Legacy products

Outcomes assessments and benchmarking involving closed products will be complex for RSEs, and is likely to deliver a questionable level of value given the difficulty of updating the benefit design of many legacy products while maintaining member value and features from prior products. For example, performance on metrics dependent on inflows will necessarily be worse for closed funds, but this does not necessarily indicate problems regarding scale or sustainability.

The significant costs associated with complying with the requirements in both SPS 220 and SPS 225 for legacy products may be counter-productive, as they would shift licensees' focus and resources away from rationalisation activities for these closed products to having to implement the proposed changes.

RECOMMENDATION: The FSC recommends APRA consider exempting RSE licensees from the new requirements under SPS 220 and SPS 225, in instances where there is a Board-approved strategy in place to migrate/terminate these legacy products, and this strategy is scheduled for completion in a realistic timeframe (for example two years).

Cost benefit analysis

The proposed changes to SPS 225 require that, following the outcomes assessment, the RSE licensee must assess the costs and benefits of implementing changes that could improve future outcomes and reflect the changes in its business plan if the cost-benefit analysis supports doing so.

As drafted, this requirement appears overly simplistic. There may be a large number of actions that may be of benefit to members at different points in time, but this does not mean that including them in a business plan, or implementing them, is appropriate.

RECOMMENDATION: the FSC recommends APRA consider clarifying the requirement to assess costs and benefits of implementing changes that could improve future outcomes.

PRUDENTIAL PRACTICE GUIDE SPG 225 OUTCOMES ASSESSMENT

Quantifying member outcomes

Member outcomes vary in the extent to which they are tangible and quantifiable. Financial outcomes such as investment returns and administration fees are generally easier to measure and compare than simplicity of products or insurance arrangements, which cannot be compared simply on cost grounds.

In particular, insurance held in superannuation provides substantial benefit for members, even though the majority will never make a claim. These benefits include the simplicity of accessing this cover, the broad nature of group insurance coverage, and the peace of mind that comes from knowing that assistance is available if a claimable event occurs.

As noted above, many of the metrics relating to insurance in the current proposals are quantitative in nature. For example, paragraph 18(c) of SPG 225 suggests a cost measure for insurance rather than a value measure.

The need to measure value, rather than cost, of insurance arrangements is also reflected in the Productivity Commission's system level objectives for insurance in superannuation, which include assessing whether the system "provides value for money insurance cover without unduly eroding member balances."

It would be useful for the guidance provided by APRA to make some distinction between measures that are more easily quantifiable, and provide some suggested approaches to measuring and reporting on those less tangible outcomes that are not financially-focused.

Paragraph 8 of SPG 225 also notes that it is not always the case that the lowest fee structure will provide better long-term outcomes, however paragraph 35 of this SPG suggests that lowering the level of cover may be an appropriate measure to improve outcomes in some circumstances.

Additional guidance through examples may be useful to illustrate other levers for improving outcomes relative to cost. One such example could be insurance arrangements that include assistance to help members return to wellness and work so they may continue their contribution towards their retirement.

Paragraph 22 of the SPG acknowledges that trustees may design insurance products to meet the needs, including cost needs, of specific cohorts. It would be useful to more clearly illustrate this with an example of when this would be appropriate, such as when the design and costs of insurance for particular cohorts may reflect their inability to obtain insurance cover on reasonable terms outside default arrangements.

Additional guidance would also be appreciated to clarify how APRA views the relationship between the best interests duty, which is forward looking and focused on the factors considered at the time of decision-making, and the outcomes assessment, which judges the outcome of those decisions with the benefit of hindsight.

RECOMMENDATION: the FSC recommends that APRA amend SPS 225 to provide greater guidance around how RSE licensees should measure and report on the less tangible outcomes associated with the provision of insurance through superannuation (such as wellness and return-to-work initiatives).

APRA should also provide additional guidance on the relationship between the forward-looking obligation to act in the best interests of members, and the backward-looking outcomes assessment process.

Interaction between APRA assessment and MySuper member outcomes test

Footnote 4 of SPS 225 indicates that a MySuper assessment required under s29VN of the SIS Act can be used to satisfy the requirements of SPS 225 in relation to that part of a trustee's business operations.

It is not clear whether this means that, although requirements under s29VN may differ to the requirements of SPS 225, for MySuper products, a trustee only needs to complete the MySuper assessment required under s29VN.

The timing of the MySuper assessment and APRA SPS 225 assessment may not coincide. For example, a trustee may complete the MySuper assessment in May and the APRA SPS 225 assessment in November of the same year. It is unclear whether this would impact the trustee's ability to incorporate a MySuper assessment to satisfy the APRA SPS 225 requirements for that MySuper product.

RECOMMENDATION: the FSC recommends APRA clarify the intended interaction between the proposed MySuper member outcomes test and the APRA member outcomes assessment.

PROPOSED ENHANCEMENTS TO THE SUPERANNUATION REPORTING FRAMEWORK

The proposed changes to the superannuation reporting framework include implementing look-through reporting.

In principle, we support APRA's goal of increasing clarity around how member funds are spent. However, in practice many FSC members would not be able to comply with these requirements, and would incur significant additional costs to implement necessary system changes.

Given the complexities of modern supply chains and service agreements, it is often difficult to accurately apply the provision of a particular service back to a particular member cohort.

In particular, our members with multiple RSE licensees and RSEs/products (including legacy products) would find it difficult to separately report expenses under bundled service arrangements, because expense information is not generally available at the required level of detail.

The costs associated with bundled services are often allocated by a parent entity based on reasonable allocation principles (in accordance with Australian Accounting Standards) and could not be easily broken down by service provider or into the specific expense categories listed in SRS 331.0. Alignment between accounting standards and all new APRA requirements will be critical in preparing information, particularly in order to avoid additional reconciliation control processes which will add to reporting costs.

Where services are outsourced, it may also be difficult to access information held by third parties relating the breakdown of services.

The FSC acknowledges APRA's intention to conduct further industry consultation on expense reporting, and we welcome this outcome given the complexities with implementing a look-through reporting approach discussed at APRA's industry roundtables in March 2018. The FSC and its members look forward to working with APRA to develop a workable and cost-effective solution.

RECOMMENDATION: the FSC recommends APRA consider whether the goals of collecting this expenditure and service provider information can be achieved in a simpler way, without substantial additional cost. We would be happy to work with APRA to determine an alternative pathway.

SIMPLIFYING MECHANISMS FOR OPTING OUT OF INSURANCE

The FSC supports the proposal to update SPS 250 to require RSE licensees to provide simple, straightforward opt-out processes for default insurance policies offered within superannuation products.

RECOMMENDATION: The FSC recommends APRA update SPS 250 to include requirements for trustees to ensure:

- members have sufficient information to make a balanced decision about their default insurance cover;
- members are provided with clear instructions on how to cancel or reduce insurance cover; and,
- the process for opting out of insurance cover is straightforward.

COMMENCEMENT

The Discussion Paper proposes that reporting changes will commence on 1 January 2019.

Given the scale of the changes flagged in the discussion paper, and the volume of regulatory change currently being embedded, it will be difficult for FSC members to fully comply within the anticipated timeframes.

There will also need to be further consideration of APRA's proposed changes if legislation with similar goals passes through parliament. It will be important to ensure that any changes made by APRA align with, and do not duplicate, legislative requirements.

RECOMMENDATION: the FSC recommends the commencement date of SPS 220 and SPS 225 be deferred to provide at least a 12 month transition period from the date of the release of final legislative and regulatory requirements before the first reporting period begins. This is required to allow industry sufficient time to fully implement changes to business and reporting processes.