

Ms Heidi Richards
General Manager, Policy Development
Australian Prudential Regulation Authority (APRA)

Sent by email: superannuation.policy@apra.gov.au

6 April 2018

Dear Ms Richards

STRENGTHENING SUPERANNUATION MEMBER OUTCOMES

Mercer's Submission

Thank you for the opportunity to provide comment on APRA's initiative to strengthen superannuation members' outcomes.

Who is Mercer?

Mercer is one of the world's leading firms for superannuation, investments, health and human resources consulting and products. Across the Pacific, leading organisations look to Mercer for global insights, thought leadership and product innovation to help transform and grow their businesses. Supported by our global team of 22,000, we help our clients challenge conventional thinking to create solutions that drive business results and make a difference in the lives of millions of people every day.

Mercer Australia provides customised administration, technology and total benefits outsourcing solutions to a large number of employer clients and superannuation funds (including industry funds, master trusts and employer sponsored superannuation funds). We have over \$150 billion in funds under administration locally and provide services to over 2.4 million superannuation members and 15,000 private clients. Our own master trust in Australia, the Mercer Super Trust, has around 230 participating employers, 224,000 members and more than \$24 billion in assets under management.

Improving member outcomes

Mercer fully supports APRA's initiative of promoting stronger risk management for the superannuation industry. We believe the focus on Strategic and Business Planning is a necessary step to raising the awareness and highlighting the importance of risk management.

Mercer also supports in principle the proposed outcomes assessment requirements in draft SPS and SPG 225 *Outcomes Assessment*; but note that the majority of the measures listed by APRA are performance related. Allowances should be made for non-performance related benefits, such as those derived from socially responsible options, digital interaction and advice, and performance levels for insurance claims – all of which we submit provide benefits to members.

We would also caution for the outcome assessments to be tempered with a practical approach so as not to incur unnecessary costs which may ultimately be passed on to members. We have highlighted some of these issues in our submission.

We appreciate from our discussions at the industry forums that drafting these guidance notes and prudential standards has been a challenging process and there may not be solutions to all the issues, particularly given it covers new ground. Where possible, we have outlined recommendations we think would address the implementation issues that we have identified. Where there are no obvious solutions, we have endeavoured to articulate the potential problems for further consideration.

Please find attached Mercer's submission to APRA's proposals.

Should you have any further queries or wish to discuss our submission, please contact Raymond Ng, our Head of Regulatory Affairs, on raymond.ng@mercer.com or (02) 8864 6887.

Yours sincerely,



Ms Michelle Mott
Chief Risk & Compliance Officer



Dr David Knox
Senior Partner

ATTACHMENT: MERCER'S SUBMISSION – STRENGTHENING SUPERANNUATION MEMBER OUTCOMES

STRATEGIC AND BUSINESS PLANNING

Mercer is supportive of the proposed strategic and business planning requirements for trustees. While attachment A of the draft SPS 220 is prescriptive in its approach, it is our expectation that many trustees would already have existing strategic and business planning processes and documents in place which, with some refinements, would satisfy SPS 220 and SPG 221.

Expense Policy

Mercer supports the proposal under draft SPS 220 that trustees should establish and maintain an expenditure policy, consistent with sound governance practice. As with the strategic and business planning process, we expect most trustees would already have in place many of the elements contemplated in the draft SPS 220 and SPG 221, such as having documented expense delegations. It is Mercer's view that the day to day application of the expenditure policy should be practical.

We suggest that it is appropriate for trustees to determine what the appropriate form of business case for significant expenditure is in their circumstance, and indeed whether a business case is required for some forms of expenditure (eg, regulatory levies and audit fees). Accordingly, we recommend that paragraph 24 of the draft SPS 220, which sets out prescriptive requirements for business cases, be moved to guidance and form part of the proposed SPG 221 instead.

We appreciate the acknowledgment in draft SPG 221 (paragraph 35) of the potential crossover with *SPS 231 Outsourcing* in relation to payments to material outsourced service providers. It is important that requirements are not duplicated and that the RSE expenditure policy can allow for fees paid to material outsourced service providers in line with SPS 231 and the trustee's outsourcing policy.

Draft SPG 221 sets out guidance in relation to the use of reserves. While the approach is sound at a high level, we recommend the following refinements to the guidance:

- Specify that any reserves held for the purpose of meeting requirements under *SPS 114 Operational Risk Financial Requirement* are to be managed in accordance with SPS 114.
- Clarify that defined benefit plans are to be managed consistent with actuarial practice and with *SPS 160 Defined Benefit Matters*; and that assets attributable to defined benefit arrangements are not considered reserves for the purposes of SPG 221.
- Acknowledge that different approaches can be taken for different sub-plans within the same RSE. For example, under a master trust, many arrangements are tailored according to the membership group (including maintaining previous arrangements under successor fund transfers). There are likely to be different approaches among sub-plans for matters such as self-insurance and treatment of unallocated assets within the fund.

Expense reporting

We understand from the discussions at the round table sessions held by APRA during March that changes to expense reporting will be the subject of more detailed consultation at a later date. We look forward to providing feedback at that time, and offer the following comments for consideration at this stage.

It is important to remember that a trustee is obligated under law and existing Prudential Standards to appoint outsourced providers on an arm's length basis and be satisfied that the terms of the arrangements are appropriate. Often, a range of services and associated fees are bundled, as recognised in the Consultation Paper.

Part of the rationale provided for changes to the expense reporting is to help improve RSE licensees' decision making. It is unclear why trustees need to make further enquiries as to how a service provider applies the fees it receives, when they have entered into an outsourcing arrangement that satisfies SPS 231 and performance of the service provider is monitored.

For example, if a related entity (Entity A) is appointed on appropriate terms, and Entity A in turn chooses to engage another related party (Entity B) to provide some of the services under subcontracting provisions, why should the RSE licensee enquire as to the nature of that engagement if it is satisfied with Entity A's delivery of services under the agreement? It is also unclear how this knowledge would help improve a trustee's decision making.

Other potential challenges we have identified with the proposals for an RSE licensee to provide more detailed reporting are:

- Information may not be readily available – either leading to considerable effort (and costs) to allocate expenses into new categories, or estimates made which may detract from the intent of the revised reporting
- Questions about the ability to compare expenses across funds – it is to be expected that different RSE licensees (and different service providers) will have varying approaches to allocating expenses to categories
- Lack of a level playing field among funds – RSE licensees who have appointed an associated entity on an arm's length basis will be subject to greater implementation and operations costs in meeting revised reporting requirements than licensees who have appointed non-associated entities.
- Commercially sensitive information – service providers may be unwilling to provide information of their cost structures (particularly as it will become publicly available) on the basis that it is commercially sensitive.

OUTCOMES ASSESSMENT

Mercer supports in principle the proposed outcomes assessment requirements in draft SPS and SPG 225; but posits that allowances should be made for non-performance related benefits, such as those derived from socially responsible options, digital interaction and advice, and performance levels for insurance claims – all of which provide benefits to members.

We also believe the outcome assessments should be tempered with a practical approach so as not to incur unnecessary costs which may ultimately be passed on to members.

However it is our view that the application of SPS and SPG 225 as currently drafted will result in significant implementation costs and/or may be impractical for some types of fund, for the following reasons:

Retail platforms

Retail platforms are generally designed to, among other things, provide members and advisers with the convenience of choice and as such, can have hundreds of investment options. Members of retail platforms are largely advised by financial advisers and utilise the availability of choice to create a diversified portfolio that suits their overall needs, risk profile, etc. As the member and their adviser are already playing an active role in ensuring suitable outcomes for the member - and are in a better position to do so than the trustee as they can consider savings outside superannuation - it is difficult to see what value the outcomes assessment for options on a retail platform will add.

We note that trustees generally already have an established process for ensuring investment options meet certain qualitative and quantitative criteria in order to be added to, or to remain on, the investment menu. As a consequence, we question the value an additional, annual outcomes assessment will add from an investment perspective.

If APRA intends to proceed with applying the outcomes assessments on retail platforms, consideration should be given to allowing the comparison of the top options which meet certain criteria (eg – top 10 investment options by Funds Under Management (FUM)).

Corporate Master Trusts

Another type of fund which will have significant implementation costs is a corporate master trust. These can have over 50 investment options, and over a hundred corporate sub-plans with different insured benefit designs, premium rates and fees. In many funds, employers subsidise some of the fees and insurance premiums for some members.

The requirements as currently drafted appear to require the trustee to carry out the outcomes assessment separately for what could be thousands of different groups of members. In this instance, we believe it would be more appropriate to conduct the outcomes assessment using a small number of representative member groups, to avoid significant compliance costs which would ultimately be borne by members.

Defined Benefits

We do not believe the outcomes assessment is relevant for defined benefit members. If a member has a defined retirement benefit of, say, “15% x final salary x service”, and all other benefits are in this form, the only way the member’s outcome could possibly vary is if the plan funding was not under control, and there are already sufficient legislative requirements governing plan funding.

Socially Responsible Investments

It is also difficult to apply an outcomes assessment to funds or investment options which have a socially responsible investment approach. We note that it is not necessarily the returns on these investments that attract members – it is the investment philosophy of the product/option that aligns with their ethical values, beliefs, principles, etc; that is the attraction. As such, members will generally be happy with the outcome even if the product/option underperforms other non-socially responsible options.

It is not clear how an outcomes assessment could be sensibly applied to such product/options. These investment options may underperform if assessed against comparable non-socially responsible options but we contend that it is not necessarily producing a bad outcome for members in this instance.

Insurance

We also believe that applying an outcomes assessment to insurance may not be desirable. Trustees already have robust approaches to ensuring premium rates for the insurance cover provided are the best available in the market through regular (typically triennial) insurance tenders. Following these tenders insurance premiums are generally guaranteed for three years and priced by the insurer on the assumption that the insurer will be retained for three years. Given this, we do not believe there is any value in benchmarking insurance on an annual basis.

Further, because insurance premiums are dependent on the insurance levels, terms and conditions, occupational profile and claims experience of the fund itself, there is generally no sensible market data against which to benchmark the premiums without seeking quotes from other insurers in the marketplace. We believe the outcomes test for insurance should be more than just the price, which should already be tested on a regular basis.

Legacy Products

Legacy products is another area that requires further consideration. These can have particular structures – such as bundling of fees and insurance premiums, or providing certain investment guarantees – which may not pass any sensible outcomes assessment but are providing the benefits and features as outlined to members when they enter into the product. We note that some of these products still exist because members choose to remain in them.

Also, in many cases the trustee has no power to change the product structure and the fees may appear relatively high because of the low scale and complex nature of the product's administration. There may also be legal obstacles to making changes to these products and significant costs of exiting it.

As a consequence, we believe some form of limited exemption for such products should be available.

Availability and timeliness of data

At the moment, there is very little timely and meaningful data available for trustees to use for their assessments. Data that is currently publicly available is either too high level or carries a time lag, making it unviable – eg, APRA's own public statistics, which carry a 12 month lag.

The only way for trustees to conduct proper and meaningful outcome assessments at this point in time appears to be through the use of investment consultants, who may have the necessary data from prior engagements with other trustees. This would make it a costly exercise, particularly for trustees with complex product offerings; and could arguably outweigh any benefit derived from the outcome assessments.

Conclusion

Given all of the issues raised above we believe the proposed requirements for the members' outcomes assessment are too prescriptive for many types of fund, particularly given a 1 January 2019 implementation date, which means trustees will need to determine the measures they are using by then. As an alternative to prescribing how trustees should consider outcomes for their members, APRA could instead seek demonstrable evidence from trustees on how they have actively engaged their members and how this shapes their outcomes and priorities.