

3 April 2018

Australian Prudential Regulation Authority
Level 12, 1 Martin Place
Sydney NSW 2000

By email: superannuation.policy@apra.gov.au

To whom it may concern

Changes to prudential standards and guidance

We refer to your discussion paper of 13 December 2017 together with four proposed Prudential Standards and Practice Guides for superannuation funds. Rice Warner is pleased to submit our comments for your consideration. We have some comments on life insurance within superannuation regarding consistency with the new Code of Practice and some comments on the relevance of the 'Sole Purpose' test, given the increasingly complex nature of superannuation.

Proposed changes to prudential standards, guidance and reporting collection

Proposed changes to prudential requirements SPS220 Risk Management (SPS 220) and the introduction of SPS225 Outcomes Assessment (SPS 225) aim to assist registrable superannuation entity (RSE) licensees (RSE licensees) to deliver sound outcomes for fund members by requiring licensees to:

- Produce a written business plan for the implementation of their strategic objective
- Have an expenditure policy that sets out how their expenditure is consistent with this strategic objective
- Require licensees to develop a business case for each significant expenditure
- Require licensees to annually assess outcomes provided to beneficiaries and identify opportunities for improving outcomes.

We agree that these changes, implemented through prudential standards SPS 220 and SPS 225, should improve practices across the superannuation industry and ultimately deliver better outcomes for members.

The proposed Prudential Practice Guides SPG 221 and SPG 225 provide funds with useful information to assist them with this strategic planning and annual outcomes assessments.

The discussion paper also outlines proposed changes to reporting collection to improve understanding of licensee expenditure by collecting financial statement information at the RSE licensee level (and not just the RSE level). Seeking feedback on the detailed consultation questions outlined in table 2 of the discussion paper will help to ensure a smooth transition to any additional reporting requirements.

Life Insurance

Proposed changes to Prudential Standard SPS 250 Insurance in Superannuation (SPS 250) are intended to simplify the process for members to opt-out of insurance products. We are supportive of efforts to standardise and simplify the process for people to opt-out of insurance held in superannuation. The process and communication of cancelling cover is covered well in sections 4.18 to 4.22 of the Insurance in Superannuation Voluntary Code of Practice (Code). It is expected that most, if not all, Funds will adopt this Code, and therefore to ensure consistency and avoid confusion, we recommend that any changes to SPS 250 and related guidance note SPG 250 are consistent with the Code.

Assessment of the sole purpose test

The discussion paper also calls for submissions to provide feedback on whether the current guidance on the sole purpose test in Circular No. III.A.4. The Sole Purpose Test (Circular No. III.A.4 of February 2001) remains relevant to the superannuation industry. Given the changing nature of the industry since the inception of Superannuation, we believe there is scope to adjust the sole purpose test to allow funds to invest a proportion of their assets in strategic investments.

Current Definition

From Circular III.A.4, the sole purpose requirements contained in section 62 of the SIS Act ('the sole purpose test'), limit the provision of superannuation benefits by regulated superannuation funds to a range of prescribed or approved retirement, or retirement-related, circumstances. These characteristics also apply to Self-Managed Superannuation Funds regulated by the ATO.

As the capital held in APRA-regulated funds grows, the services provided to members tends to become more complex. Examples include sophisticated financial advice and complex life insurance offers. A forthcoming example will be the introduction of Comprehensive Income Products in Retirement (CIPRs) where super funds will need to manage longevity risk on behalf of their retired members. In some cases, this will mean using capital to provide guarantees.

Expanding into non-superannuation fields

From time to time, there have been calls for superannuation to be used in all sorts of capital-intensive activities, such as helping people to buy a home, or to fund health and aged care benefits late in life. These all fall outside the Sole Purpose Test but funds often form partnerships or invest in ventures which can provide these facilities for their members. Provided that government and the community are comfortable for superannuation funds to use their scale and negotiating power to help members, there is nothing intrinsically wrong with these arrangements. However, where fund assets are used, the investment must fall within a fund's investment strategy and pay a reasonable risk-adjusted return.

The strict application of the Sole Purpose test makes it difficult for superannuation funds to diversify their services within the fund. For example, funds cannot provide banking products to members as this is not a core purpose. However, they can facilitate lending by providing introductions to their membership. An example of this is Members Equity Bank. This ADI is owned by many industry funds, which hold the asset as a 'private equity' investment within the overall pool of members' investments.

As the assets of the superannuation industry grow, there will be increased calls to use them for other purposes. Provided the investment strategy is not weakened, the funds will continue to broaden their asset classes in much the same way they have done over the last two decades. However, not all these investments are at arm's length and the investment return is not publicly monitored relative to other investments.

All superannuation funds want to provide a greater number of services to members and this can be costly. There is an argument to allow beneficial investment in some entities even if they don't always provide a full market return to members. A good example is financial advice where the service helps to improve members' retirement outcomes. Usually, this diversification means building extra resources in-house, which increases fees for members. Alternatively, funds can invest externally in software for their planners or in a separate financial advice business.

So, as funds diversify, they can buy or rent the extra services or they can outsource completely to expert businesses, all of which increase member fees. However, in some of these cases, funds may choose to invest in **strategic assets** which deliver some non-investment benefits for members in a different way. In a superannuation fund run by a financial institution, these might be held by a related-party business and the trustees will ensure the service is purchased at a fair price. With all other funds the trustees lack the capital to buy these entities so some have purchased them on behalf of the members as private equity investments. Most of these will provide a commercial return but some could only be justified by including various non-tangible benefits for members.

Many such private equity investments held by funds are large businesses. For example, First State Super members own State Plus (retirement products and a financial advice business for members/retirees); QSuper members own QInsure (a life company) and QInvest (financial advice). Members in several funds own shares in IFM and Frontier which are leading businesses in their fields.

Allowing funds to hold strategic assets

As the superannuation industry expands, these types of investments will grow and trustees will occasionally have the dilemma of a non-superannuation business failing to provide a satisfactory investment return. If it is still delivering some important member benefits, it will be difficult to divest.

None of this was foreshadowed when the SIS Act was prepared and it is time to consider restructuring these investments. One option is to allow trustees to maintain reserves of (say) 1% of fund assets which can then be invested in **strategic assets** which provide services to members. This gives a transparent framework and avoids the conflict of putting capital into assets which might have a lower expected return than other private equity investments. It would be prudent for APRA to monitor all strategic assets and ensure they are beneficial for the members of the fund.

Clarification of cessation of work due to ill health

Circular III.A.4 currently allows payment of superannuation benefits on cessation of work due to total and permanent incapacity or temporary incapacity. We believe the circular could further clarify what constitutes permanent or temporary incapacity. For example, explicit clarification as to what constitutes a terminal illness and under what circumstances a person with a terminal illness can receive their benefit would be beneficial.

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We hope you find this information useful in the policy development and implementation process.

Yours sincerely

A handwritten signature in black ink that reads "Michael J. Rice". The signature is written in a cursive style with a large, stylized 'J'.

Michael Rice
CEO & Authorised Representative
Rice Warner Pty Ltd AFSL 239 191