insight

ISSUE ONE | 2013

Superannuation industry overview

Data integrity in superannuation

insight

ISSUE ONE | **2013**

Disclaimer and copyright

Contents

Superannuation industry overview

This article provides an overview of recent developments in the superannuation industry, particularly that part regulated by APRA. It also discusses APRA's views on the key risks and issues facing the industry as it implements significant reforms.

Introduction

The implementation of the Government's *Stronger Super* reforms will be the dominant feature of the superannuation industry landscape in 2013 and beyond. APRA's new prudential standards, which introduce heightened obligations for registrable superannuation entity (RSE) licensees in many areas of their operations, will be in place from 1 July 2013 and new MySuper products will be introduced.

These regulatory changes will be taking effect after another unsettled period for superannuation funds, which has seen both economic and demographic impacts continue to shape the outlook for the industry. Although monies invested in the superannuation system continued to grow over the year to end-June 2012, this was largely due to strong member inflows with the rate of growth impacted by flat investment performance over the period. Since then, equity markets have performed strongly and returns are looking healthier.

APRA's primary focus over 2013 is on the implementation and embedding of the Stronger Super reforms.

Further structural changes are expected, with membership continuing to age, ongoing industry consolidation and the drift of assets to the self-managed superannuation sector. As the impacts of Australia's ageing population work their way through the superannuation system, there will be heightened demand for pension products (e.g. guaranteed products) and growing liquidity pressures as payments are made to retirees. While outflows may be offset by the increasing rate of the Superannuation Guarantee, APRA will be closely monitoring how the industry deals with these pressures.

APRA's primary focus over 2013 is on the implementation and embedding of the *Stronger Super* reforms.

Stronger Super reforms

The *Stronger Super* reforms, which largely take effect from 1 July 2013, will drive significant changes in the superannuation industry. The industry's level of preparedness for these changes will be critical.

The *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* grants APRA, for the first time, the power to make prudential standards in superannuation. In November 2012, APRA released a package of eleven prudential standards for superannuation in the areas common to other industries as well as some specific to superannuation. In December 2012, APRA released for consultation the first tranche of supporting prudential guidance and the second and final tranche was released in early May 2013.

The *Superannuation Legislation Amendment (MySuper Core Provisions) Act 2012* and *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012* set the legislative framework for APRA to authorise RSE licensees to offer MySuper products from 1 January 2013. In December 2012, APRA released the MySuper authorisation and transition application package.

The final tranche of MySuper legislation was introduced into Parliament on 29 November 2012. The *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Bill 2012*, together with other tranches of legislation already introduced, continues the Government's commitment to enhancing the governance and integrity of Australia's superannuation system.

In addition to the MySuper and governance components of the *Stronger Super* reforms, legislation has been passed to enable improved administrative efficiency in the superannuation system (SuperStream), to target superannuation tax concessions towards lower income earners (Fairer, Simpler Super) and to facilitate the introduction of several other measures to further ensure the integrity of the system.

In addition to prudential standards, APRA has engaged in extensive consultation with the industry on new reporting requirements for superannuation. These requirements implement the transparency and accountability elements of the *Stronger Super* reforms and support the implementation of prudential standards, MySuper products and SuperStream. The new reporting requirements provide greater transparency of investments and costs in superannuation and enhance APRA's ability to supervise RSE licensees and funds. The final package of reporting forms was released on 28 March 2013 for commencement from 1 July 2013 for many forms.

The superannuation industry is now concentrating on the implementation of the new prudential regime.

Superannuation industry overview

The superannuation industry is now concentrating on the implementation of the new prudential regime. Many RSE licensees have been undertaking work to identify gaps between their current operations and the requirements of the new prudential standards and to develop plans to close these gaps. They are reviewing and modifying their existing policies, processes and practices to meet the new standards. The proposed new reporting requirements, along with the introduction of SuperStream, are also expected to necessitate significant system changes. Preparedness for data collection and SuperStream measures will require a particular focus on data quality.

The implementation and embedding of the reforms now dominate APRA's regulatory priorities in superannuation. APRA will continue its interactions with RSE licensees to ascertain their strategies for responding to the reforms. For RSE licensees that propose to offer a MySuper product, conversations will revolve around their approach to offering the product and the manner in which it will be introduced. Where RSE licensees decide not to offer the product, the focus will be on their plans for identifying members with accrued default amounts that would need to be transferred to a suitable authorised MySuper product by 1 July 2017, as required by Prudential Standard SPS 410 MySuper Transition. Where RSE licensees contemplate exit from the industry, APRA will look to ensure that they take timely and well-considered decisions that give due regard to members' best interests.

RSE licensees are strongly encouraged to liaise with APRA on their preparations for MySuper, prudential standards and enhanced data collection to enable early detection and resolution of any potential issues. At the time of this publication, 53 MySuper applications had been received by APRA, of which 31 have been authorised to offer the product. The quality of applications has been high, particularly where RSE licensees had consulted with APRA prior to lodgement.

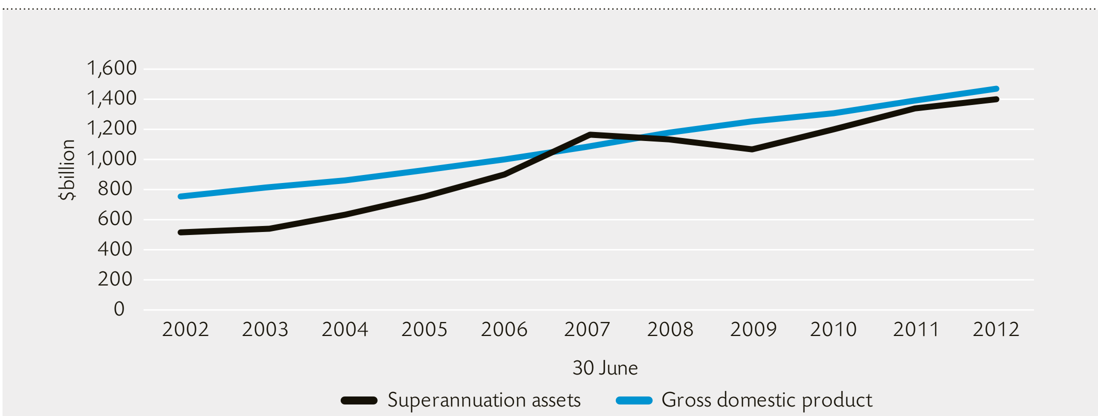
Overview of the superannuation industry

Statistical returns show an industry that continues to grow, largely supported by the compulsory nature of the Superannuation Guarantee contribution. However, growth has not been even across the industry. Self-managed superannuation funds (SMSFs) and industry funds have increased their market share while the corporate fund sector has continued to contract. There has also been further consolidation between industry funds and within wealth management groups, as the industry comes under increasing pressure to deliver the benefits of scale to its members. Overall, the outflow of funds from the APRA-regulated sector has continued, reflecting a significant shift towards the SMSF sector as well as an increase in benefit payments as a growing proportion of Australia's population enters retirement.

Superannuation assets

Over 2011/12, the value of total superannuation assets increased by 3.7 per cent to $1.4 trillion, equivalent to 94.5 per cent of Australia's GDP (Figure 1).

Figure 1: Superannuation assets and nominal GDP



Source: APRA *Annual Superannuation Bulletin*, June 2012

With investment performance flat over this 12-month period, growth was largely driven by strong contribution inflows. However, improved investment performance in the second half of 2012 saw growth accelerate to take total estimated superannuation assets to $1.5 trillion.

Future growth in superannuation assets will be underpinned by the phased increase in the rate of the Superannuation Guarantee from 9.0 per cent to 12.0 per cent over the next six years.

Industry structure

The composition of the superannuation industry in Australia continues to evolve.

In the decade to 30 June 2012, SMSFs have experienced very strong growth to become the single largest sector, accounting for 31.4 per cent of total industry assets as at 30 June 2012.[1] The retail funds sector was the second largest sector, accounting for 26.5 per cent of total industry assets at that date. The industry funds sector was the second fastest growing sector, accounting for 19.1 per cent of total industry assets and the only APRA-regulated sector that increased its market share over the decade. Public sector and corporate funds represented 15.9 per cent and 4.0 per cent of total industry assets, respectively, as at 30 June 2012[2].

The superannuation industry has also continued to consolidate. The number of APRA regulated RSEs with more than four members declined by 9.5 per cent from 367 to 333 over 2011/12 (Figure 2). This figure has fallen to 325 as at 31 December 2012.

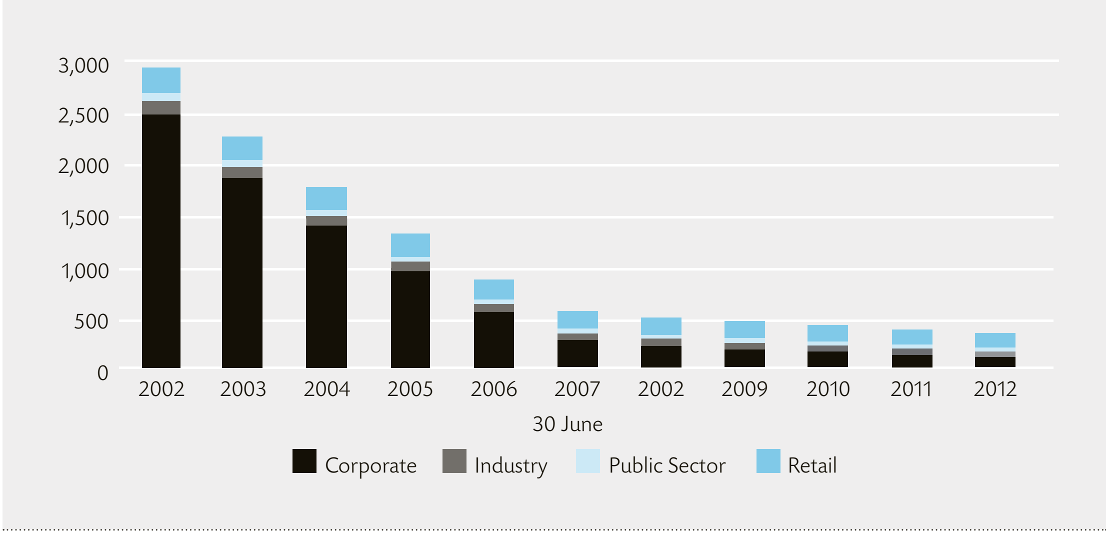
The most significant decline in numbers was in the corporate funds sector. Mergers have also taken place between industry funds and between and within wealth management groups, the latter driven both by rationalisation following intragroup mergers and by decisions to streamline fee structures, investment strategies and insurance offerings in readiness for MySuper.

The number of RSE licensees fell from 225 to 209 over 2011/12, and has fallen further to 199 as at 31 December 2012.

As at 30 June 2012, the largest 20 superannuation funds measured by assets comprised six industry, ten retail, three public sector and one corporate fund. Assets of these funds accounted for 57.3 per cent of total industry assets and 52.5 per cent of members of APRA-regulated funds with more than four members, Appendix 1.

1 Measured to exclude Small APRA Funds
2 *APRA Annual Superannuation Bulletin*, June 2012

Figure 2: Number of RSEs with more than four members



Source: APRA *Annual Superannuation Bulletin*, June 2012

Looking ahead, the reinstatement of temporary loss relief for fund mergers occurring between 1 October 2011 and 2 July 2017 under the *Superannuation Laws Amendment (Capital Gains Tax Relief and Other Efficiency Measures) Act 2012* and increasing pressure on RSE licensees to demonstrate scale efficiencies are likely to encourage further consolidation within the industry. In this environment, RSE licensees will need to pay particular attention to the management of operational risks, especially data integrity risk.

The number of member accounts increased by 1.0 per cent to 31.9 million in the 12 months to 30 June 2012. The most notable increase was in the SMSF sector, where accounts grew by 7.9 per cent. In contrast, the number of member accounts in the corporate funds sector decreased by 7.2 per cent, reflecting ongoing contraction of the sector and the migration of large balances to the SMSF sector. A number of legislative measures targeting small, inactive and multiple accounts are expected to materially reduce the number of superannuation accounts within the industry.

Member flows

Net contribution flows

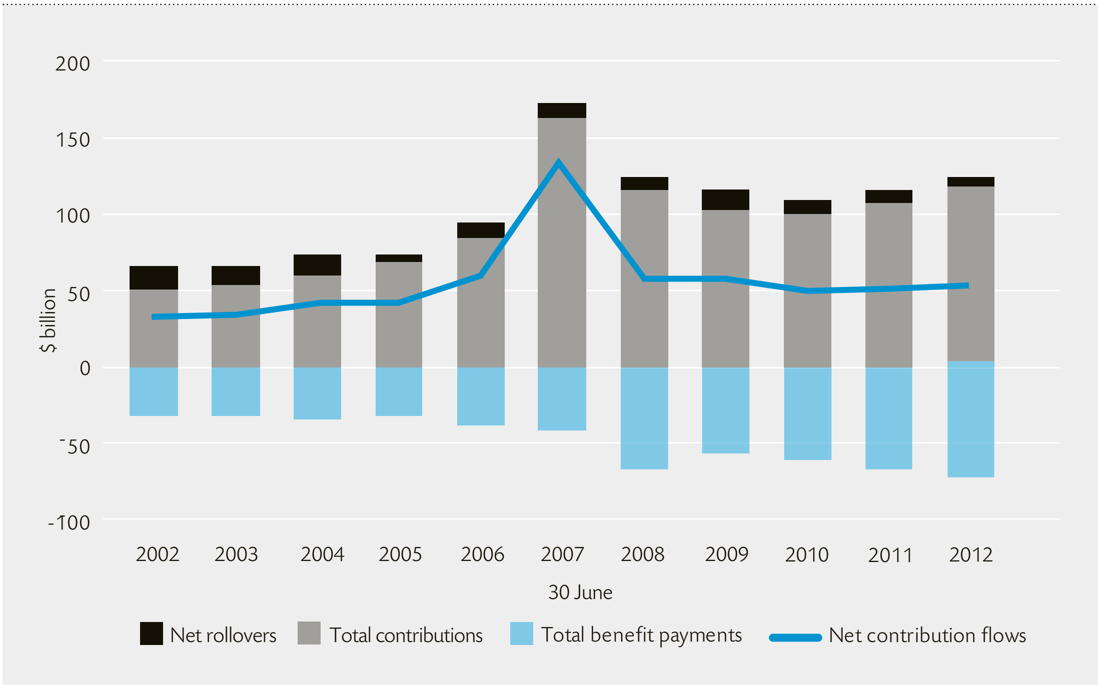
Over the year to 30 June 2012, net contribution flows for the industry increased by 7.7 per cent to $54.7 billion (Figure 3).

While the industry as a whole remained cashflow positive, with continued strong contribution inflows, the ratio of withdrawals to contributions has been increasing. With the exception of industry funds, net contributions declined across all APRA-regulated sectors of the industry, with corporate funds experiencing a net outflow over 2011/12.

Contributions

Over this period, contributions increased by 10.3 per cent to $117.5 billion. Contributions from employers were the key driver of this growth. Discretionary member contributions remained flat reflecting softer economic conditions and fragile investor confidence. Looking ahead, the growth in contributions will be impacted by the offsetting forces of the rising rate of the Superannuation Guarantee and the reduction in concessional caps for individuals aged over 50.

Figure 3: Net contributions flow



Source: APRA *Annual Superannuation Bulletin*, June 2012

Benefit payments

Over the same period, total benefit payments increased by 9.2 per cent to $69.7 billion. The largest outflow of funds in the form of benefit payments came from the retail funds and public funds sectors. The pace of growth in benefit payments is expected to accelerate in the future as the population ages.

The value of pension payments has continued to increase within the APRA–regulated sector as a growing percentage of retirees opt for an income stream (Figure 4).

Further growth in the value of pension payments can be expected, reinforced by a reduction in the existing pension drawdown relief, concessional tax treatment and an increase in the percentage of members who will draw a higher minimum balance of their pension account as an income stream.

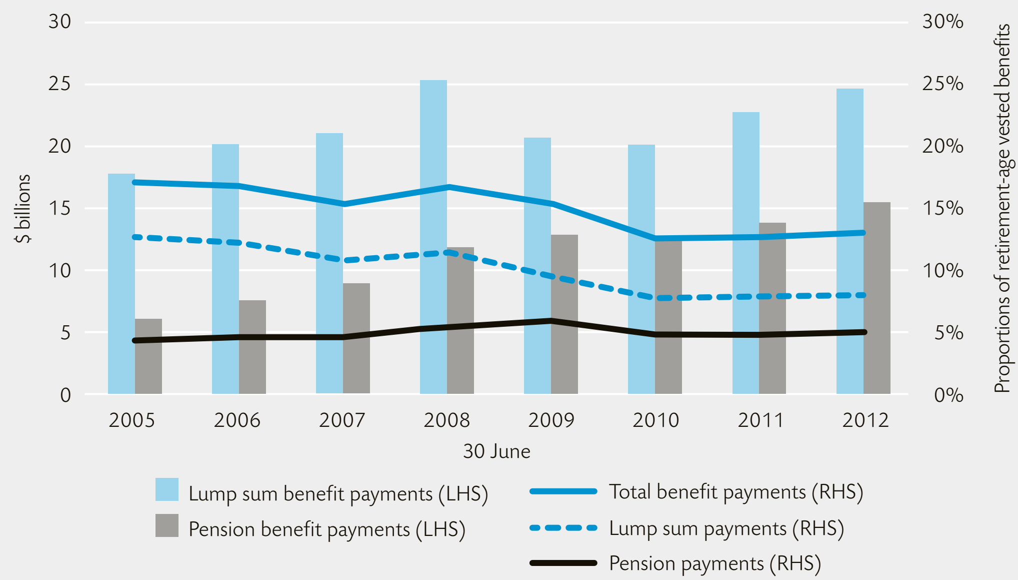
Net rollovers

Net rollovers for the superannuation industry declined by 16.3 per cent to $7.0 billion over the year to 30 June 2012. Net rollovers from the APRA-regulated sector have been negative since 2008. The increase in outflows reflects the leakage of large balances to the SMSF sector (Figure 5).

In an environment of increasing net outflows, liquidity management to accommodate these outflows needs to be a key consideration for RSE licensees.

The value of pension payments has continued to increase within the APRA–regulated sector...

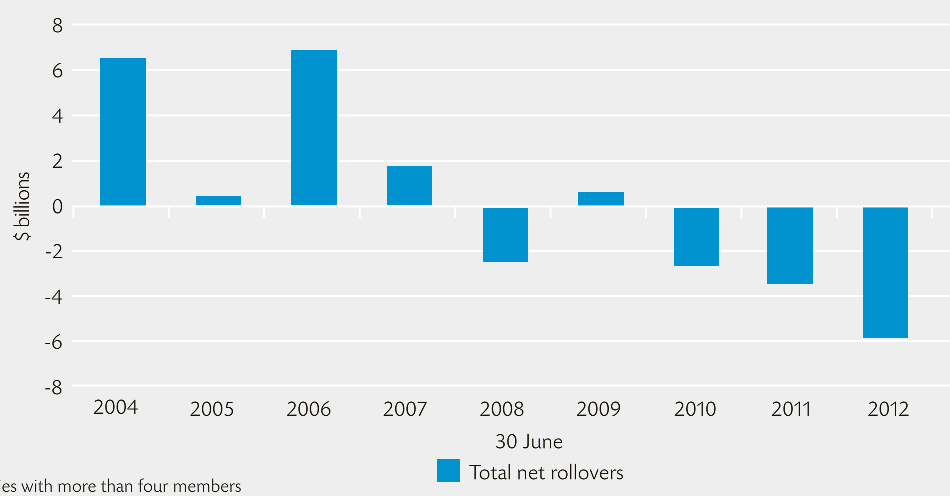
Figure 4: Pensions payments and lump sum payments*



* Excludes exempt public sector superannuation schemes, small funds and eligible rollover funds

Source: APRA *Annual Superannuation Bulletin*, June 2012

Figure 5: Net rollovers*



* Entities with more than four members

Source: *Annual Superannuation Bulletin*, June 2012 and previous editions

Industry demographics

The membership of superannuation funds in Australia has continued to age. Members aged 60 and over held 10.0 per cent of superannuation member accounts and 33.4 per cent ($361 billion) of vested benefits at June 2012. This compares to 6.5 per cent of member accounts and 23.2 per cent ($161 billion) of vested benefits at June 2005. Members aged between 50 and 59 ('approaching retirement') also held a significant proportion of vested benefits (Figure 6).

For some time now, the percentage of members transitioning from the accumulation to the pension phase has increased faster than the annual growth in the accumulation membership; indeed, the growth in the accumulation members has been declining since 2009. These trends are expected to continue over the medium- to long-term as a reflection of demographic shifts within the industry. With these shifts, there will be greater demand for new products to manage longevity risks and a need for closer oversight of product risks by RSE licensees.

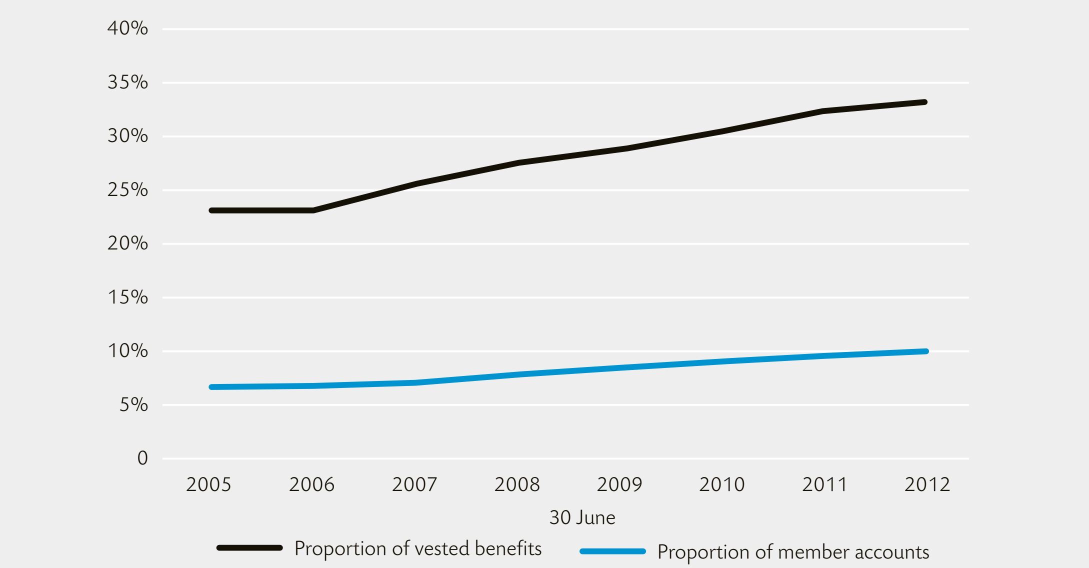
Asset allocation

Since 2009, there has been a steady increase in allocation to default strategies. As at 30 June 2012, 42.9 per cent of total assets held by RSEs[3] were held in the default investment strategy. Industry and public sector funds had a higher proportion of assets in the default strategy than retail funds. A further increase in the allocation to default strategies (including MySuper) is expected, consistent with continued lack of engagement by members.

Movements in the allocation of investments in the default strategy have continued to reflect a heightened demand for safer assets in an uncertain economic environment (Figure 7). Though the majority of default strategy assets remained in Australian and international equities, there has been an observable increase into cash. Some funds have also increased their weighting to infrastructure, private equity and other alternative strategies.

3 Measured to exclude Small APRA Funds

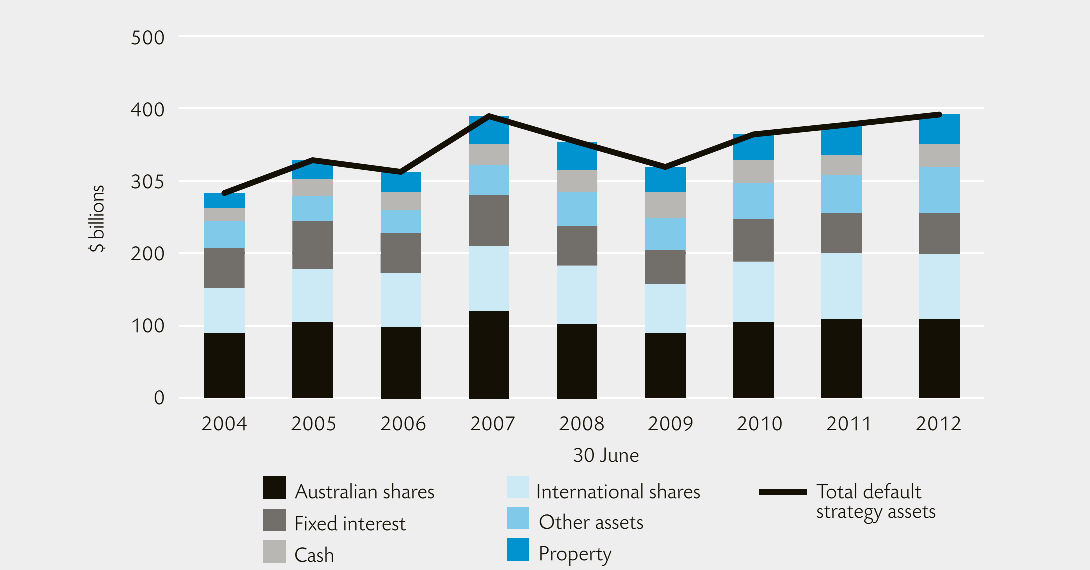
Figure 6: Members aged 60 and over*



* Entities with more than four members

Source: APRA *Annual Superannuation Bulletin*, June 2012

Figure 7: Default asset allocations*



* Entities with more than four members

Source: *Annual Superannuation Bulletin,* June 2012 and previous editions

Structure of retirement benefits

As at June 2012, 82.5 per cent of benefits in RSEs comprised accumulation benefits and 17.3 per cent defined benefits. Assets in hybrid funds (funds with a combination of accumulation and defined benefit members) comprised 55.9 per cent of superannuation assets at June 2012[4] (Figure 8).

The data highlights a steady contraction in the defined benefit sector that is expected to continue. APRA expects RSE licensees to have a robust process in undertaking conversions to accumulation benefit structures.

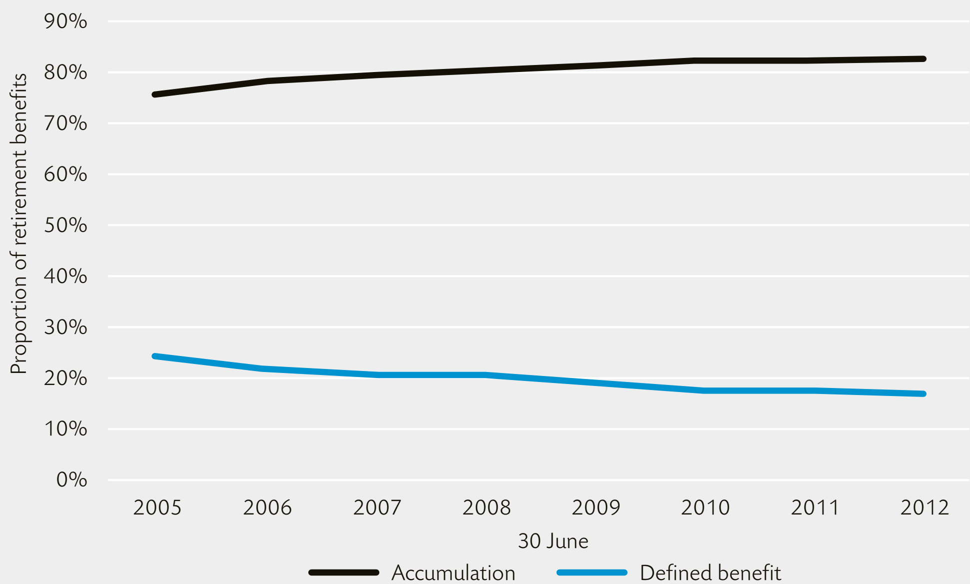
Key supervisory issues

Regulatory reforms will sharpen the focus of RSE trustees and of APRA on a number of key areas, including board governance, risk management, investment and operational risks. Within this context, the following risk areas have received heightened supervisory attention from APRA:

- data integrity;
- liquidity;
- risks arising in mergers;
- funding and solvency of defined benefit funds; and
- risk management.

4 APRA classifies RSEs as defined benefit, accumulation or hybrid, where hybrid entities have a combination of defined benefit and accumulation members. Hybrid entities are not required to report the assets allocated to defined benefit and accumulation retirement benefits. However, APRA estimates the assets allocated to the two types of benefits.

Figure 8: Structure of retirement benefits*



* Entities with more than four members

Source: *APRA Annual Superannuation Bulletin*, June 2012

Data integrity

RSE licensees have been slow to respond to calls for improvements in this area, despite regular messages to the industry from APRA on the importance of data integrity in meeting obligations to beneficiaries. Many RSE licensees appear reluctant to become engaged on this issue until presented with large-scale data problems, typically arising in transitions to new administration platforms or administrators. However, over the last 12 months, the level of awareness about this issue has risen, with an increasing number of examples of RSE licensees adopting a proactive and coordinated whole-of-fund approach to identifying and responding to data issues in areas such as member details, benefit calculations, unit prices and insurance.

The issue of data integrity in superannuation is discussed in more detail in the accompanying article in this edition of *Insight*.

Liquidity

Liquidity risk management

In an environment characterised by investment volatility, an ageing demographic, industry consolidation, migration of large balances to the SMSF sector, frozen investments and illiquid asset allocations, the liquidity risk management of RSE licensees naturally receives continued supervisory attention from APRA. The need to meet fiduciary and other obligations in this environment highlights the importance of formulating and giving effect to investment strategies that have adequate regard to liquidity risk and implementing appropriate liquidity management practices.

The superannuation industry has been focussing more on liquidity risk management practices since the global financial crisis but there remains scope for further improvement...

The superannuation industry has been focussing more on liquidity risk management practices since the global financial crisis but there remains scope for further improvement, particularly in the areas of liquidity monitoring and liquidity stress testing. The new *Prudential Standard SPS 530 Investment Governance* (SPS 530) is expected to spur improvements. SPS 530 introduces a new requirement for RSE licensees to have a liquidity management plan that outlines procedures for measuring and monitoring liquidity on an ongoing basis. In formulating such a plan, RSE licensees must consider how liquidity would be managed in a range of stress scenarios and actions to be taken in response to adverse liquidity events. The supporting draft *Prudential Practice Guide SPS 532 Investment Risk Management* outlines APRA's expectations of RSE licensees in these areas. APRA will be following up with RSE licensees on how they are implementing and embedding the required changes to their liquidity management practices.

Portability

Many retail superannuation funds continue to hold investments in 'frozen funds' (mortgage and property managed investment schemes). Although some managed investment schemes have been winding up and others restructuring, the resolution of these frozen investments continues to be a slow process that is influenced by underlying impaired assets and valuation concerns. APRA continues to encourage RSE licensees to challenge the Responsible Entities of these schemes on the future of these investments and, where appropriate, apply pressure to negotiate definitive outcomes for their members. In seeking any future relief from portability requirements, RSE licensees are expected to demonstrate that the relief application is based upon there being, in the absence of such relief, a significant adverse impact on the fund or on other members of the fund not invested in the frozen option. A suitable materiality threshold should be set to determine this impact.

Exposure to unlisted assets

Investments in difficult-to-value, lumpy, unlisted assets such as property, infrastructure and private equity pose particular challenges for liquidity management. Unlisted assets are attractive for superannuation funds due to their long-term earnings and smoothed volatility profile, but APRA has reminded RSE licensees to carefully consider the liquidity implications of investing in these assets.

Mergers have the capacity to expose significant weaknesses in data quality that may affect RSE licensees' ability to meet their obligations to beneficiaries.

Mergers and acquisitions

Ongoing contraction in the number of APRA-regulated funds through mergers gives rise to operational and governance risk. Mergers have the capacity to expose significant weaknesses in data quality that may affect RSE licensees' ability to meet their obligations to beneficiaries. The impact of the likely systems changes to accommodate superannuation reforms may exacerbate this risk. In addition, RSE licensees need to be mindful of any current or potential conflicts of interest arising in mergers. Any such conflicts must be appropriately identified and managed to ensure that any merger decisions are made proactively in the best interests of beneficiaries.

Other important considerations for RSE licensees in mergers include the establishment of strategic alignment between the merger partners and the potential to realise benefits of scale for the members, managing organisational complexity, legal issues surrounding equivalency of rights assessment, trust deed changes, impact on accrued benefits, short-term liquidity issues and potential adverse implications for insurance offerings.

APRA expects RSE licensees to consider the whole spectrum of risks arising in mergers and to ensure that their entities have sufficient capacity and resourcing to manage these risks, while ensuring ongoing business operations. To this end, APRA expects RSE licensees to develop a structured approach to mergers involving the Board upfront, specifying a merger charter that links to the risk appetite statement approved by the Board and prescribing a management function to manage the project without impeding business-as-usual operations. APRA continues to encourage an open dialogue with merging RSEs in order that any significant issues are identified and addressed early.

RSE licensees have been devoting greater attention to risk management, but the superannuation industry remains significantly below the level of maturity observed in other APRA-regulated industries.

Funding and solvency of defined benefit funds

Notwithstanding the recovery in investment markets over 2013, some of the defined benefit funds and sub-funds remain in an unsatisfactory financial position, and their funding and solvency continues to be closely monitored by APRA. APRA's scrutiny includes assessing the adequacy of investment return assumptions in the context of the investment strategies adopted, reviewing termination provisions in the trust deeds to determine their workability, questioning any intentions by RSE licensees to vary the benefit formula and the consequential impact on members and ensuring that RSE licensees remain cognisant of the financial position of key employers, given the pressure on employers' balance sheets in some industries where large-scale retrenchments have taken place.

RSE licensees have been devoting greater attention to risk management, but the superannuation industry remains significantly below the level of maturity observed in other APRA-regulated industries.

APRA's new prudential standards introduce greater rigour and formality into the funding and solvency practices of RSE licensees. Prudential Standard SPS 160 Defined Benefit Matters (SPS 160) defines an 'unsatisfactory financial position' in terms of vested benefits and sets a period of no longer than three years within which a fund must be restored to a satisfactory financial position. In addition, SPS 160 introduces heightened obligations in relation to regular valuations, and the monitoring and reporting of funding plans, as well as new requirements in respect of interim valuations. APRA expects RSE licensees to assess the impact of the new requirements on their funds and to engage with all stakeholders to the funding process to assess their capacity to meet these requirements. APRA also expects RSE licensees to flag to it any potential funding concerns as early as possible.

Risk management

RSE licensees have been devoting greater attention to risk management, but the superannuation industry remains significantly below the level of maturity observed in other APRA-regulated industries. There is scope for further improvement in the areas of resourcing for risk management, understanding of risks by RSE licensees, segregation between compliance and risk management functions, independent assurance, frequency of review, monitoring and reporting on risks, breadth of oversight within risk management functions and engagement of RSE licensee Boards on the issue of risk management.

The new *Prudential Standard SPS 220 Risk Management* (SPS 220) establishes heightened obligations for RSE licensees in this area. SPS 220 formalises the requirements that RSE licensees have adequate systems, policies and processes for identifying, assessing, managing, mitigating and monitoring material risks that may affect their ability to meet their obligations to beneficiaries. Draft *Prudential Practice Guide SPG 220 Risk Management* further clarifies APRA's expectations of RSE licensees in meeting these requirements and, more broadly, outlines prudent practices in relation to risk management.

Some of APRA's risk management requirements may present challenges for RSE licensees. These include the definition and articulation of risk tolerance and risk appetite, linking risk appetite to strategic plans, and developing a designated and robust risk management function that is functionally independent from business units. RSE licensees are encouraged to develop good practice in these areas, in line with the other APRA-regulated industries.

Conclusion

Implementation and embedding of the *Stronger Super* reforms will shape APRA's focus on the superannuation industry in 2013 and beyond. The introduction of prudential standards, the MySuper product regime and new reporting requirements will demand careful attention from RSE licensees, at a time of continuing economic and market uncertainties and significant structural changes within the industry. APRA will continue to work closely with RSE licensees as they manage the implementation process to ensure that the industry delivers on its obligations to members in a sustainable manner.

Dina Phillips
Principal Industry Analyst (Superannuation)
Industry Analysis

Appendix 1[5]

Top 20 superannuation funds by asset size at 30 June 2012

Rank	Fund	Type	Public Offer	Assets ($ billion)		Members	
				June 2012	June 2011	June 2012	June 2011
1	AMP Superannuation Savings Trust	Retail	Y	51.9	51.5	2,858,947	2,858,220
2	AustralianSuper	Industry	Y	47.8	43.4	1,901,653	1,809,564
3	State Public Sector Superannuation Scheme	Public Sector	N	43.5	41.2	548,560	543,071
4	Colonial First State FirstChoice Superannuation Trust	Retail	Y	43.2	41.2	726,371	663,894
5	Retirement Wrap	Retail	Y	34.2	28.7	623,368	489,815
6	First State Superannuation Scheme	Public Sector	Y	34.0	31.8	755,293	770,520
7	The Universal Super Scheme	Retail	Y	33.9	32.2	1,271,516	1,165,253
8	Unisuper	Industry	N	32.6	30.9	471,673	468,053
9	OnePath Masterfund	Retail	Y	26.1	26.7	958,365	960,532

5 Excludes exempt public sector schemes

Appendix 1[6] - continued

Top 20 superannuation funds by asset size at 30 June 2012

Rank	Fund	Type	Public Offer	Assets ($ billion) June 2012	Assets ($ billion) June 2011	Members June 2012	Members June 2011
10	Retail Employees Superannuation Trust	Industry	Y	22.6	21.1	2,016,874	1,957,328
11	Sunsuper Superannuation Fund	Industry	Y	20.2	18.9	1,162,621	1,140,392
12	Health Employees Superannuation Trust Australia	Industry	Y	19.8	18.5	754,386	724,867
13	Construction and Building Unions Superannuation	Industry	Y	18.9	17.5	691,582	663,333
14	ASGARD Independence Plan Division Two	Retail	Y	15.8	16.0	316,106	316,048
15	Mercer Super Trust	Retail	Y	15.7	15.6	242,264	234,502
16	Wealth Personal Superannuation and Pension Fund	Retail	Y	14.0	13.6	119,991	114,563

6 Excludes exempt public sector schemes

Appendix 1[7] - continued

Top 20 superannuation funds by asset size at 30 June 2012

Rank	Fund	Type	Public Offer	Assets ($ billion)		Members	
				June 2012	June 2011	June 2012	June 2011
17	MLC Superannuation Fund	Retail	Y	13.2	9.0	90,514	74,827
18	Public Sector Superannuation Scheme	Public Sector	N	13.0	12.5	237,492	240,237
19	IOOF Portfolio Service Superannuation Fund	Retail	Y	12.9	13.4	414,281	416,844
20	Telstra Superannuation Scheme	Corporate	Y	12.5	11.7	104,667	103,294
Total assets of Top 20 funds ($ billion)							**525.7**
Total assets of large funds ($ billion)							**917.4**
Share of assets of large funds (%)							**57.3**
Share of total member accounts of large funds (%)							**52.5**

7 Excludes exempt public sector schemes

Data integrity in superannuation

This article examines the risks around poor data integrity in superannuation and outlines the enhanced data management requirements for Registrable Superannuation Entity (RSE) licensees under the *Stronger Super* reforms.

Introduction

To successfully meet their obligations to members, it is essential that Registrable Superannuation Entity (RSE) licensees have a data management framework that ensures complete, accurate and timely member data. Over recent years, APRA has stressed to RSE licensees that they need to pay attention to fund data quality and its management. APRA has also been focussing on this issue during its supervision activities and many of the Government's *Stronger Super* reforms emphasise the importance of data integrity. While there has been some improvement, it is APRA's view that RSE licensees still have a good way to go before the industry can be considered to be handling the issue well.

Data integrity risk

Data integrity refers to the accuracy, completeness, consistency, timeliness, availability, confidentially and fit-for-purpose nature of data items. RSE licensees remain responsible for data integrity, even if data collection and maintenance is performed by an external service provider.

Data integrity is at the heart of a robust member record-keeping system. It is critical that superannuation funds maintain the integrity of key data items, as they form the building blocks for superannuation members' entitlements and fund reporting. An administration system relies on correct data to be able to produce correct member entitlements for members and provide accurate reporting of key statistics to stakeholders across the industry, including employers, service providers, regulators and commentators.

Data integrity risk has a number of dimensions, each of which has important potential effects on the beneficiaries and stakeholders of superannuation funds. Examples include fraud due to theft of data, business disruption due to data corruption or availability, transaction failure due to inaccurate data, and breach of legal or compliance obligations resulting from disclosure of confidential data.

At a basic level, failure to maintain accurate member identification records can mean that members do not receive their proper entitlements or can lead to the creation of duplicate accounts and increased and unnecessary administration and insurance charges. Failure to maintain accurate records of member investment choice may lead to misallocation of overall fund assets and expose the RSE licensee to litigation if members experience losses as a consequence.

Data integrity risk has a number of dimensions, each of which has important potential effects on the beneficiaries and stakeholders of superannuation funds.

The accuracy of data that records member investment choice is of obvious importance as RSE licensees undertake the transition of accrued default amounts to MySuper products between 1 July 2013 and 30 June 2017. APRA's reporting requirements released on 28 March 2013 include *Reporting Standard SRF 410.0 Accrued Default Amounts*, which requires quarterly reporting to APRA of the number of accounts with an accrued default amount and the value of members' benefits that are accrued default amounts as at the end of each reporting period.

Causes of poor data

The causes of poor data are many and varied. They can range from inadequate and incorrect data being provided by employer-sponsors, poor IT administration system design and maintenance, poor governance and inadequate human, technical and financial resources. Many of these are in fact interconnected. For example, poor investment in and governance over fund administration functions (which are largely outsourced to external service providers) has led to poor system design and maintenance.

RSE licensees' attention to the issue of data integrity and to the key drivers of data integrity risk has tended to be quite poor. Many have failed to recognise the importance of data quality on members' benefits and, consequently, have been reluctant to become engaged on this issue, often only becoming engaged when large-scale problems have arisen as a result of poor quality data. Alternatively, others have only become engaged when confronted by the need to investigate and rectify data errors or anomalies whilst undertaking transitions to new administration platforms or administrators.

APRA has observed that many RSE licensees, absent any specific data quality issue, still do not have processes in place for periodic testing and cleansing of data. When issues do arise, the approaches to remediation are sporadic rather than systemic.

Data integrity risk is an operational risk. As such, it would typically be covered in the risk management framework...

To help address this, APRA had been placing an increased focus on data integrity in its supervision work and, in July 2012, wrote to the RSE licensees of all regulated superannuation entities to highlight the issue. APRA noted its expectation that RSE licensees should be proactively preparing for the introduction of the SuperStream and related reforms announced by the Government following the *Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation Industry* (Cooper Review). This would not only involve RSE licensees reviewing their systems and processes for the introduction of the new SuperStream data and e-commerce standards but also ensuring that they have a robust process in place to regularly review and report on the quality of member data for completeness and accuracy.

In particular, APRA advised RSE licensees that they should be focussing on a number of data items such as members' full name, date of birth, address, mobile phone number, tax file number, date joined fund, beneficiary and gender, which are critical to the accurate and timely calculation of members' benefits. RSE licensees would need to demonstrate that they have these processes in place in order to meet the requirements in APRA's prudential framework.

One problematic area for data integrity is legacy information. As RSE licensees make changes to benefit design, change key service providers such as administrators, merge with other funds and combine records from multiple IT systems, the quality of historical records can suffer. There is potential, in particular, for duplicate accounts to be created.

Industry response

The level of awareness of RSE licensees about data integrity appears to have increased over the last 12 months and this has translated into gradual progress in responding. More RSE licensees are now adopting a proactive and coordinated process to regularly identify and respond to data issues at a whole-of-fund level. In many cases, RSE licensees have been assisted in this process by a number of specialist external service providers that are equipped to assist in the interrogation of large data sets to identify data integrity issues and, in some cases, make recommendations on how to remediate any problems uncovered. One of these service providers, ITM, has partnered with the Australian Superannuation Funds Association (ASFA) to develop a 'Data Benchmark' and, since 2010, has been reporting this benchmark to industry in order to highlight the issue of data integrity across a number of areas. This benchmark seeks to measure, across a sample of funds that participate in the survey, the percentage of member records that have important basic data that is missing or incorrect.

The most recent ASFA/ITM benchmark survey in September 2012 covered 25 funds with a combined membership of 2.8 million members. The results indicated that 22 per cent of member records have an error in one or more audited data fields[1].

APRA's prudential requirements relating to data integrity

There are a number of developments related to the *Stronger Super* reforms that will help consolidate the gains being made in this area. Some have already come into effect, while others will be phased-in over the coming years. These include APRA's prudential standards and guidance, SuperStream and APRA's reporting requirements.

1 http://www.superannuation.asn.au/resources/asfa-itm-bench-mark/

Data integrity in superannuation

APRA released final prudential standards in superannuation in November 2012. APRA's requirements on data quality and management are addressed in four prudential standards:

- *Prudential Standard SPS 220 Risk Management* (SPS 220);
- *Prudential Standard SPS 231 Outsourcing* (SPS 231);
- *Prudential Standard SPS 250 Insurance in Superannuation* (SPS 250); and
- *Prudential Standard SPS 114 Operational Risk Financial Requirement* (SPS 114).

Data integrity risk is an operational risk. As such, it would typically be covered in the risk management framework and would form part of the considerations for a RSE licensee in determining its operational risk financial requirement (ORFR) target required in SPS 114. In the draft guidance material released for consultation in November 2012, paragraphs 57 to 59 in *Prudential Practice Guide SPG 220 Risk Management* outline guidance regarding information systems that would typically form part of the risk management framework to facilitate reporting of risk issues. APRA expects prudent RSE licensees to have controls for ensuring data in information and reporting systems is current, accurate and complete. The adequacy of resources requirements in paragraph 38 of SPS 220 specify that a RSE licensee must have adequate technical resources, which include adequate hardware, data quality and software.

APRA expects prudent RSE licensees to have controls for ensuring data in information and reporting systems is current, accurate and complete.

When outsourcing material business activities, SPS 231 emphasises the importance of managing data by requiring that outsourcing agreements address, among other matters, 'the form in which data is to be kept and clear provisions identifying ownership and control of the data'. APRA's draft guidance material *Prudential Practice Guide SPG 231 Outsourcing* highlights areas of particular concern with regard to data quality. For example, data security and quality risks are equally important when outsourcing to a domestic service provider or an offshore service provider. APRA expects that offshore arrangements uphold at least the same standards as domestic outsourcing agreements. APRA also expects that the quality of data maintained by service providers will be monitored and data quality assurance testing performed and reported to the RSE licensee on a regular basis.

Data quality is a particular issue for insurance offered within superannuation. APRA has, for some time, expressed concern about the group life market, including concerns about the poor data used for pricing. APRA has included a specific requirement in SPS 250 that RSE licensees must 'maintain records of sufficient detail for a prospective insurer to properly assess the insured benefits that are made available. These records must include, for at least the previous five years, the claims experience, membership, sum insured and premiums paid in relation to beneficiaries.' Paragraphs 14 to 22 of draft *Prudential Practice Guide SPG 250 Insurance in Superannuation* provide guidance on data management related to the provision of insurance in superannuation.

Data integrity in superannuation

In addition to the superannuation-specific requirements and guidance material, APRA released a draft version of cross-industry *Prudential Practice Guide 235 Managing Data Risk* (PPG 235) in December 2012 for consultation. PPG 235 provides relevant guidance for the superannuation, banking and insurance industries on managing data risk and targets areas where APRA continues to identify weaknesses as part of its ongoing supervisory activities. These include the need for a systematic and formalised approach that includes an overarching data management framework and the need to consider the life-cycle of data management: i.e. data capture, processing, retention, publication and destruction. One of the key components of a data management framework should be the existence of a robust, automated and repeatable process for the validation, correction and cleansing of data. The framework should contain processes for the regular assessment of data quality over time and the reporting of such assessments to the Board. Programs that maintain an overall level of staff awareness of the importance of data integrity should also be a feature. APRA supervisors will be looking to emphasise these messages when discussing with RSE licensees their oversight of data integrity.

Overall, the requirements in the prudential standards place an onus on RSE licensees, as fiduciaries, to actively consider their own funds' data integrity and any impacts on their members and a range of other stakeholders.

The expanded reporting standards for superannuation entities will further require RSE licensees to be diligent in the management of their data. APRA released the reporting requirements on 28 March 2013 and they will phase-in over two years from 1 July 2013. APRA recognises that complying with the new reporting requirements may necessitate systems changes and updating of agreements with external service providers to collate the information required to be reported to APRA. APRA expects that RSE licensees will maintain a focus on data integrity throughout this implementation phase.

The expanded reporting standards for superannuation entities will further require RSE licensees to be diligent in the management of their data.

APRA notes that The Pensions Regulator (TPR) in the United Kingdom also has a focus on improving data integrity in pension funds. In June 2010, TPR issued guidance regarding data integrity and introduced quantitative expectations on data accuracy. The introduction of specific requirements has led organisations to tackle the issue of data quality more seriously. TPR commenced by defining a set of common data fields where minimum data standards were introduced and characterised the data as either legacy data (data created before June 2010) or new data (data created after June 2010). Targets were set requiring trustees to achieve complete and accurate data for 95 per cent of legacy data and 100 per cent of new data by 31 December 2012. TPR has recently announced that it will be conducting surveys of pension funds during 2013 to establish whether pension funds have met these targets.

Other *Stronger Super* measures and data integrity

The Government's SuperStream reforms will give rise to a common data standard to be used by all industry participants for the transmission of data, such as contributions and rollovers.

The Australian Taxation Office (ATO) has finalised the *Superannuation Data and Payments Standards 2012 Legislative Instrument*[2]. The transition period for these new standards is from 1 July 2013 to 1 July 2016. APRA and the ATO wrote to RSE licensees on 15 March 2013 regarding several aspects of SuperStream.

From 1 July 2013, APRA-regulated funds will be required to use new data and e-commerce standards for the processing of inbound rollovers.

From 1 July 2013, APRA-regulated funds will be required to use new data and e-commerce standards for the processing of inbound rollovers. RSE licensees will need to review their transition process with the ATO between September and December 2013 to test their capability to send rollovers in a manner compliant with the data and payment standards. Each APRA-regulated fund has been assigned a date during this period by which it must demonstrate compliance with the standards for rollovers. Funds seeking to vary their assigned date need to consult their APRA supervisor.

Large and medium-sized employers will be required to use the new standard when making superannuation contributions from 1 July 2014 and small employers from 1 July 2015.

2 http://www.ato.gov.au/superfunds/content.aspx?doc=/content/00335171.htm

The data and payment standards, while central, are only part of the SuperStream suite of reforms, and are supported by enabling services offered by the ATO.

One aim of introducing common data and payment standards is to improve data integrity in the superannuation system via communication of standardised data items in messages associated with the payment of rollovers and contributions. The success of the SuperStream reforms will rest on a collective effort by industry to operate as a network to communicate and transact rollovers and contributions amongst all APRA-regulated funds. APRA is encouraged by the leadership being provided to the industry by the SuperStream Advisory Council and the work that is underway to establish governance and technical standards for operating within the network.

APRA will have administration of the data and payments standards for APRA-regulated funds. Although APRA does not expect to use its penalty powers routinely, APRA can issue infringement notices to RSE licensees that breach the data and payments standards. APRA expects that RSE licensees will notify it of compliance issues as part of the breach notification process.

The data and payment standards, while central, are only part of the SuperStream suite of reforms, and are supported by enabling services offered by the ATO.

From 1 July 2013, RSE licensees and Retirement Savings Account (RSA) providers will be required to use the Super Tax File Number (TFN) integrity check (Super TIC) service to validate new member details when accounts are first opened, on receipt of the first contribution or before making a rollover to another APRA fund. RSE licensees will be able to securely enter the TFN and other identity data provided by a member on the Super TIC service, and receive back a confirmation or error message. As the ATO develops its system, if sufficient identification data is provided but the TFN is incorrect, the ATO expects to be able to provide the correct TFN to the fund. Ensuring that valid TFNs are associated with each member account is fundamental to improving data integrity in each superannuation fund.

In similar vein, employers will be able to use the Employer TIC service from July 2014 to validate employees' TFNs.

In the 2012/13 Mid-Year Economic and Fiscal Outlook, the Government announced that reforms will be implemented to preserve the value of lost member accounts in the superannuation system and ensure that more of these accounts are reunited with their owners.

From 2 April 2013, RSE licensees have been required to populate the ATO's fund data validation service with their identification details including fund name, a unique identifier and the fund's bank account details. This data will be available to other funds on an interim basis from 1 July 2013 and on a permanent basis from 1 July 2014 to facilitate rollovers between funds.

Data integrity will be further enhanced by the removal from the system of a significant body of corrupt or unusable data through measures to remove lost members. In the 2012/13 Mid-Year Economic and Fiscal Outlook, the Government announced that reforms will be implemented to preserve the value of lost member accounts in the superannuation system and ensure that more of these accounts are reunited with their owners. From May 2013, the account balance threshold below which inactive accounts and accounts of uncontactable members are required to be transferred to the ATO will be increased from $200 to $2,000, and the period of inactivity before an account of an unidentifiable member is required to be transferred to the ATO will be reduced from five years to 12 months.

The ATO will use its data-matching resources to match these lost accounts with members and assist those members to be reunited with their lost superannuation. The Government will consult further on additional ways to facilitate this process of reuniting members with their lost accounts. In addition, from 1 July 2013 the Government will credit interest, at a rate equivalent to CPI inflation, to all superannuation accounts transferred to the ATO, at the time they are reclaimed from the ATO.

Another element of the superannuation system where data integrity is weak is Eligible Rollover Funds (ERFs). It is well recognised, and acknowledged by many existing ERF providers, that the quality of data in relation to many members of ERFs has been poor. As part of the *Stronger Super* reforms, from 1 January 2014 all ERFs must be authorised by APRA rather than simply self-identifying as an ERF. Conditions for authorisation will include a requirement that the governing rules of the fund require that the only purpose of the fund is to be a temporary repository for amounts transferred to the fund from other regulated superannuation funds in circumstances allowed by the RSE licensee law, and an assessment by APRA that the RSE licensee is likely to comply with the enhanced RSE licensee obligations for ERFs. The principal additional obligation is that the RSE licensee must promote the financial interests of the beneficiaries of the fund, in particular, returns to those beneficiaries (after the deduction of fees, costs and taxes).

APRA is looking to accelerate the pace of change on data quality throughout the industry.

The emphasis on ERFs as a short-term repository for members' money, together with the enhanced data verification tools offered by the ATO, should lead to an increased emphasis on data cleansing as part of an improved effort to match ERF members with active interests in other funds. Combined with the more robust definition of lost member accounts, this should result in reduced numbers of members with an interest in an ERF and improved data quality for those who remain.

APRA's supervision

APRA is looking to accelerate the pace of change on data quality throughout the industry. APRA's prudential standards give it the ability to require RSE licensees to take greater ownership of data integrity. APRA has written several letters to RSE licensees relating to SuperStream and it will continue to communicate with industry on its expectations for this important reform. In particular, APRA wrote to RSE licensees in July 2012 highlighting the introduction of SuperStream and the new superannuation prudential standards relating to data quality, and reinforcing APRA's expectations on how RSE licensees should be managing data integrity risk.

APRA's prudential standards give it the ability to require RSE licensees to take greater ownership of data integrity.

APRA expects that RSE licensees are preparing themselves for superannuation reforms, particularly SuperStream and APRA's enhanced data collection, by identifying and addressing data quality and data systems issues. Key steps in addressing data quality include, but are not limited to:

- benchmarking data quality within the RSE licensee's business operations on critical data items to identify areas of concern;
- updating risk management frameworks to incorporate data risk management policies, processes, controls and reporting;
- reviewing relevant outsourcing arrangements to incorporate data integrity risk management into the outsourcing agreement;
- reviewing insurance arrangements to ensure the RSE licensee has access to relevant insurance data; and
- preparing for the ATO's transition process for rollovers in a timely manner.

Conclusion

After a slow start, there are now signs that RSE licensees are beginning to adopt more proactive practices in the management of data. However, APRA still has much work to do to encourage more RSE licensees down this path. The key areas of reform (SuperStream, prudential standards and reporting requirements) provide new impetus for RSE licensees to be aware of the importance of data integrity. In particular, the reforms highlight the criticality of a regular and active process to validate, correct, cleanse and assess the ongoing quality of data. Regular reporting to senior management and the Board on data quality issues is essential to enable appropriate focus on data integrity.

The *Stronger Super* reforms represent a key turning point for the industry in the management of data integrity risk and an opportunity to place the receipt and management of data on a surer footing.

Katrina Ellis
Senior Manager
Policy Development

Roger Brown
Senior Advisor
Policy Development

Notes

APRA OFFICES

Head Office

SYDNEY

Level 26
400 George Street
Sydney NSW 2000
GPO Box 9836
Sydney NSW 2001

Tel: 02 9210 3000
Fax: 02 9210 3411

Info Line: 1300 55 88 49
Web: www.apra.gov.au

ADELAIDE

Level 22
25 Grenfell Street
Adelaide SA 5000
GPO Box 9836
Adelaide SA 5001
Tel: 08 8235 3200
Fax: 08 8232 5180

BRISBANE

Level 23
300 Queen Street
Brisbane QLD 4000
GPO Box 9836
Brisbane QLD 4001
Tel: 07 3001 8500
Fax: 07 3001 8501

CANBERRA

Level 2
243-251 Northbourne Ave
Lyneham ACT 2602
GPO Box 9836
Canberra ACT 2601
Tel: 1300 131 060
Fax: 02 6213 5307

MELBOURNE

Level 21
Casselden Place
2 Lonsdale Street
Melbourne VIC 3000
GPO Box 9836
Melbourne VIC 3001
Tel: 03 9246 7500
Fax: 03 9663 5085

PERTH

Level 15, QV1 Building
250 St Georges Terrace
Perth WA 6000
GPO Box 9836
Perth WA 6001
Tel: 08 9481 8266
Fax: 08 9481 8142