



AUSTRALIAN INSTITUTE of  
SUPERANNUATION TRUSTEES

# Strengthening Member Outcomes

6 April 2018

## AIST Submission to APRA

### AIST

**The Australian Institute of Superannuation Trustees** is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the \$1.2 trillion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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### Executive summary

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We welcome the opportunity to comment on the *Strengthening Superannuation Outcomes* discussion paper and accompanying material released in December 2017 (the proposals). Given the issues we have raised in this submission, AIST would be very pleased to further discuss these issues with APRA.

We strongly support the key theme underpinning the proposals that there be an ongoing focus on improving member outcomes. The draft prudential standards and practice guides also have the aim of seeking to improve the strategic and business planning and expenditure management of responsible superannuation entities (RSE).

We agree that the objectives of providing financial safety, efficiency, competition, contestability and competitive neutrality – while promoting financial stability - are important and need balancing. We highlight that for the proposals to work at their best, there are three key issues which are fundamental and need addressing:

1. The superannuation system currently cannot be meaningfully benchmarked. This arises from differences in fee, cost and return disclosure. AIST believes it is difficult to properly assess ‘outcomes’ in these circumstances. The proposals refer to RSEs developing benchmarks and APRA’s expectations that RSEs would refer to external sources of information.
2. There are various disclosure gaps which erode the regulatory framework and do not deliver a level playing field. These gaps make it difficult to properly undertake an outcomes test.
3. Clarity is needed regarding how the proposals will interact with the proposed design and distribution obligations and product intervention powers (Treasury consultation).

We now turn to our key views regarding the proposals.

**Outcomes assessment:** We support measures that strengthen the obligation on superannuation trustees to consider the appropriateness of their product offering through ensuring value and quality. We appreciate the non-prescriptive approach taken.

However, the outcomes assessment criteria should give *primacy* of focus to long-term net returns. Long-term net returns are what the member receives. We appreciate that this *value* proposition must be backed with RSEs also delivering *quality* outcomes through, for example, sound financial and business practices. The regulatory system also needs to accommodate tactical investment options such as cash, which achieve lower net returns.

We agree with the proposals in that RSE licensees would be required to undertake assessments which reflect the structure of their businesses – including the range of products, investment options and sub-plans. We believe that this would mean an assessment for each MySuper and

Choice product investment option, specifically excluding defined benefit options and including all legacy products. However, we would welcome clarification of whether this was to extend to multiple assessments across multiple sub-plans as well as separate consideration of the accumulation and retirement phases.

**Strategic and business planning:** We also support requirements for RSE licensees to have a business plan and expenditure policy in place to support the implementation of the RSE licensees' strategic objective. However, we query their inclusion within prudential standards. We also strongly support that the proposals reflect an emphasis on business planning and expenditure *process*.

That being said, we support the proposed requirement for business plans to detail the basis for setting fees. This requirement should be tightened to ensure RSE licensees are required to detail the basis for setting fees for Choice products and investment options, which on average charge higher fees.

**Reporting framework:** In principle, we support the proposed enhancements to the superannuation reporting framework. However, there are several issues detailed below that must be addressed. Collecting more detailed expenditure data must not take priority over addressing the prolific gaps within the reporting framework for Choice products. AIST also calls for the development of a more comprehensive data reporting framework, which could cover criteria against which calls for additional data are assessed, as well as what industry may expect back in terms of the enablement of analysis. These issues become even more important with the introduction of the member outcomes assessment.

**Insurance:** We support a requirement for RSE licensees to provide a simple opt-out process for all insurance products. The industry is committed to improving standards in relation to insurance, highlighted by the *Insurance in Superannuation Voluntary Code of Practice* (Insurance Code of Practice).

**Sole purpose test:** It is essential for all trustee decisions to be made in accordance with the sole purpose test in the *Superannuation Industry (Supervision) Act 1993*. The superannuation circular on the sole purpose test is an important part of the regulatory framework and should be updated and maintained.

**Timing:** If the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017* is passed, a review of the proposals would be needed.

### AIST recommendations

We have set out below a number of recommendations, the basis for which we outline in our submission. In summary:

Recommendation	Details
<p><b>1. Systemic regulatory carveouts should be addressed</b></p>	<p>While AIST recognises that this is a longer-term project, we highlight that member outcomes assessments cannot be properly undertaken in a system which cannot properly benchmark fees, costs and returns owing to these carveouts.</p>
<p><b>2. Further consultation is needed to examine the interaction between other proposals</b></p>	<p>AIST seeks clarity as to how these proposals will work. We are concerned that if either or both of the following Bills are passed, further consultation should occur to consider the effect upon the proposals:</p> <ul style="list-style-type: none"> <li>(i) <i>Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017</i>; and</li> <li>(ii) <i>Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017</i>.</li> </ul>
<p><b>3. The outcomes assessment criteria should give primacy to long term net returns</b></p>	<p>We appreciate that the value proposition of the primacy of long-term net returns needs to be backed with quality and value outcomes, e.g. sound financial and business practices. Long-term net returns should have primacy, given this is what the member actually receives.</p>
<p><b>4. While we agree that there should be an assessment for each MySuper investment option, further clarity is needed regarding inclusion of Choice options, use of the ‘same’ investment option across sub-plans, clarity as to how the member outcomes</b></p>	<p>AIST believes that further clarity is needed, and notes that a number of our member funds have raised this lack of clarity.</p> <ul style="list-style-type: none"> <li>• AIST recommends that where the ‘same’ option has been used across several sub-plans, a simple statement that an assessment has been conducted could be included.</li> </ul>

<p><b>test is to apply to both accumulation and retirement options, cash and other options, inclusion of legacy products, also the exclusion of defined benefit schemes.</b></p>	<ul style="list-style-type: none"> <li>• AIST recommends that clarity be given to ensure that Choice investment options are included.</li> <li>• AIST recommends that it be clarified that legacy products are included.</li> <li>• AIST recommends that clarity be provided regarding application of the member outcomes assessment to accumulation and retirement options.</li> <li>• AIST recommends that clarity be provided regarding application of the member outcomes assessment to cash and other options.</li> </ul>
<p><b>5. Defined benefit options must be excluded.</b></p>	<p>Given the nature of defined benefit schemes, they should be excluded.</p>
<p><b>6. The proposed member outcomes assessment must include a consideration of risk-adjusted or risk-referencing net returns</b></p>	<p>Risk and returns must be considered conjointly to better protect members' best interests.</p>
<p><b>7. Include cross-references to other APRA prudential standards which impact on assessing value and quality.</b></p>	<p>We suggest that other APRA prudential standards and guides which impact on assessing value and quality might be referred to within draft SPS 225, e.g. SPS/SPG 231 Outsourcing.</p>
<p><b>8. The methodology surrounding the appointment of an independent person to review a particular approach of an RSE licensee needs both greater transparency and clarity through inclusion of criteria within SPG 225</b></p>	<p>AIST notes that there is no guidance as to how this proposal would work in practice.</p>
<p><b>9. While AIST supports the need to have board approved strategic objectives and a</b></p>	<p>AIST believes that the draft prudential standards appear to run counter to the principles of prudential regulation.</p>

<p><b>business plan in place, we query their inclusion within prudential standards.</b></p>	
<p><b>10. A data reporting framework should be developed</b></p>	<p>AIST strongly believes that the development of a data reporting framework is needed to give both transparency and clarity against which requests for further data may be assessed and the manner in which data will be reported back to the industry.</p>
<p><b>11. Data needed for superannuation funds to be able to benchmark themselves should be specified.</b></p>	<p>Currently, funds are unable to properly benchmark themselves against others. This arises from both the carveouts from the regulatory framework as mentioned above, but also from a lack at system level of identifying what data is needed to benchmark. Such specifications are also needed to help determine the efficiency of the system.</p>
<p><b>12. Expenditure reporting must enable the identification of related party costs which impact on superannuation funds.</b></p>	<p>AIST believes that greater clarity is needed about how expenditure reporting is to occur to enable transparency of any cross-subsidisation of related party costs.</p>
<p><b>13. The meaning of ‘significant’ expenditure requires clarity.</b></p>	<p>AIST believes that the concept of significance should align to the RSE’s Risk Management Framework and include the cost of outsourced expenditures.</p>
<p><b>14. There is merit in examining a standard insurance opt-out process for insurance products across the industry.</b></p>	<p>AIST supports a requirement for RSE licensees to provide a simple opt-out process for all insurance products.</p>

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### Key issues

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#### 1. Outcomes assessment

##### 1.1 Foundation stones to help the proposal work at its best

AIST strongly agrees with the proposal, and its goal of ensuring that good value and quality outcomes are delivered to members.

AIST also strongly agrees with the proposal's aim to balance safety, efficiency, competition, and competitive neutrality. We believe that there are two key issues which underpin a successful delivery of the proposal:

- The superannuation system is not currently in a state where it can be meaningfully benchmarked. This arises from differences in how fees, costs and returns are calculated and disclosed. AIST believes it is difficult to properly assess 'outcomes' in these circumstances. The proposals refer to RSEs developing benchmarks and APRA's expectations that RSEs would refer to external sources of information.
- There are various disclosure gaps which have eroded the regulatory framework, and which do not deliver transparency, comparability, or a level playing field. These gaps also make it difficult to properly undertake an outcomes test.

We appreciate that addressing these issues would require a longer-term solution.

##### 1.2 Outcomes assessment – overall

Under the proposal, trustees will be required to annually assess outcomes provided to beneficiaries and identify opportunities for improving these outcomes through the RSE licensee's business operations. The draft requirements specify that the assessment must cover all beneficiaries, detail the outcomes sought by the trustee and have regard to the fund's investment strategy, insurance offering, scale, product features and fund expenditure.

We support measures that strengthen the obligation on superannuation trustees to consider the appropriateness of their product offering. We agree in broad terms with items which are included as driving value and quality outcomes. We suggest that other APRA prudential standards and guides which impact on assessing value and quality might be referred to within draft SPS 225, e.g. SPS and SPG 231 Outsourcing.

The Pensions Regulator in the United Kingdom has developed a Code of Practice that sets out the standard of conducted expected by trustees of occupations pension schemes. The Code states that:<sup>1</sup>

*Poor value for members is a key risk that trustee boards need to manage...*

We agree with this observation and welcome the measures. However, the following issues must be addressed:

- The primary focus of the assessment criteria should be long-term net returns. This is what the member receives – it is the most important *value* which the fund delivers.
- The secondary focus of the assessment criteria should be on the other elements which deliver value and in a quality fashion.
- The degree to which assessments reflect the structure of their businesses – including the range of products, investment options and sub-plans – must be clarified and confirmed. Where a fund has, for example, the ‘same’ investment option across a number of sub-plans or between accumulation and retirement phases, a simple statement could be included that consideration has occurred, rather than requiring an outcomes assessment for all instances of that product across sub-plans.
- Defined benefit products should be excluded.
- The regulator must set its expectations regarding retirement products.
- Clarity is needed as to how other current reforms affect member outcomes assessments.

We also have concerns regarding how the provisions of clause 10 in draft SPS 225 would operate: this states that APRA may require an RSE licensee, by notice in writing, to appoint an appropriate independent person to provide a report on a particular aspect of an RSE licensee’s approach to, and completion of, the outcomes assessment (with the RSE licensee bearing the cost). We note that there is no guidance in the proposals as to how this would work. AIST strongly recommends that a series of criteria be included in SPG 225. For example:

- APRA may appoint an independent person only in cases where it reasonably believes it does not have sufficient internal resources or expertise to undertake the work itself.
- APRA has provided prior notice to the RSE licensee as to its concerns. This would provide an opportunity for the RSE licensee to address the concerns.

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<sup>1</sup> The Pensions Regulator (2016). *Code of Practice 13: Governance and Administration of Occupational Trust-based Schemes Providing Money Purchase Benefits*. [online] p.27. Available at: <https://tinyurl.com/y94l4wxh> [Accessed 23 Mar. 2018].

- Where APRA proceeds with appointing an independent person, this is reflected in the outcome of APRA's performance management processes and reporting.

### 1.3 Net returns

AIST believes that further work is needed to properly include the value of net returns in the outcomes test. There are a number of issues which need to be addressed.

Most importantly, the primary benefit of value delivered to members is net returns and this is not suitably reflected in the proposal. Net returns are the key factor that is likely to have the largest impact on a member's retirement adequacy. While AIST acknowledges that the value of net returns needs to be backed through the delivery of quality products and services, the proposal as currently drafted does not give adequate weight to the key outcome to members – net long-term returns.

The proposed assessment is flawed because it does not expressly require trustees to assess the net returns provided to beneficiaries. The proposed assessment requires trustees to consider the outcomes they seek to provide to beneficiaries, and the metrics used to assess the delivery of these outcomes, but it does not specifically require the trustee to consider long-term net returns. It also does not specifically require trustees to consider risk-adjusted or risk referencing net returns. While the prudential guidance notes that the Australian Prudential Regulation Authority (APRA) expects the trustee to take a broad approach to considering outcomes, that may include a consideration of 'net returns'. This is not sufficient to adequately advance the interests of fund members.

In addition, we note the following changes should also be made:

- AIST recommends that clause 8 of the draft SPS 225 be amended to include that (as the key factor) long term net returns must be included in an RSE licensee's outcomes assessment.
- The proposal needs to consider how cash and other options are to be assessed under the outcomes test.
- Possible differences between the assessment of both pre- and post-retirement options may also need to be included.
- The proposed assessment must expressly include a consideration of risk-adjusted or risk referencing net returns. Risk and returns must be considered conjointly in order to better protect members' interests.

### 1.4 Product level assessment required

The proposed standard reads:<sup>2</sup>

*An RSE licensee must annually assess outcomes provided to beneficiaries and determine whether future outcomes could be improved through changes to its business operations (the outcomes assessment).*

*The outcomes assessment must cover beneficiaries across the entirety of an RSE licensee's business operations and be approved by the board.*

The proposed guidance confirming that RSE licensees have a discretion as to how to segment their members for the purpose of completing the outcomes assessment needs clarification. We agree with the proposals in that RSE licensees would be required to undertake assessments which reflect the structure of their businesses – including the range of products, investment options and sub-plans. We believe that this would mean an assessment for each MySuper and Choice product investment option, excluding defined benefit option and including all legacy products – and we agree with this (we refer for example, to clause 8(e) of draft SPS 225).

We believe from the wording of draft SPG 225 *Outcomes assessment* that this would mean that where a fund has, for example, including the 'same' investment option across a number of sub-plans, a simple statement could be included that this consideration has occurred.

We would appreciate further consultation and clarity about these issues. Additional considerations would need to be given where the 'same' investment option has been used for both the accumulation and retirement income phases. We would also appreciate further clarification of whether the retirement phase should be considered separately to the accumulation phase.

If an assessment is at 'fund level' there is real concern that poorly performing products will not receive adequate scrutiny by trustees and will continue to be offered, despite not being in the best interests of those members (as explained at draft SPG 225, paragraph 14). For example, there are an estimated 40,000 different member investment choices within the industry<sup>3</sup> – there is no evidence that each of these is in the best interests of members.

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<sup>2</sup> Proposed Prudential Standard SPS 225 – Outcomes Assessment, p 6–7.

<sup>3</sup> Derived from comments made: Rowell, H. (2015). *Governing Superannuation in 2015 and beyond: Facts, Fallacies and the Future*. [online] APRA. Available at: <http://tinyurl.com/hla6osb> [Accessed 7 March 2018].

One of the underlying rationales of the proposed outcomes assessment is for “members in all products provided by an RSE licensee [being able] to have confidence that they are being provided sound outcomes”.<sup>4</sup>

The table below outlines the products we believe should be assessed, and the reasons why they must be assessed.

**Table 1 – Products which should be assessed**

Product	Additional reasons why a product level assessment is essential
<b>MySuper</b>	We support detailed scrutiny of MySuper product offerings for a variety of reasons, including the fact that they are default products and are offered to a significant number of members.
<b>Choice</b>	<p>There is less regulatory oversight, disclosure and publicly available performance data for these products. The additive effect of lower regulatory oversight and information asymmetry means that it is very difficult for members assess the value proposition of these products.</p> <p>In 2017 SuperRatings research found substantial differences between fees for MySuper and Choice products, particularly within retail superannuation funds – even when the underlying asset allocations were almost identical.<sup>5</sup></p> <p>Data from Rice Warner in 2017 revealed that the value of retirement savings in pre-retirement Choice products and investment options is almost double of that in MySuper products.<sup>6</sup></p> <p>2017 SuperRatings research found that median profit-to-member funds significantly outperformed their retail counterparts.<sup>7</sup></p> <p>We agree with the intention of the draft SPS 225 that it is essential for a product level assessment to apply to Choice products for a number of reasons including the large number of investment choices, the limited</p>

<sup>4</sup> Australian Prudential Regulation Authority, ‘Discussion Paper: Strengthening Superannuation Member Outcomes’ December 2017, p 16.

<sup>5</sup> The Australian Institute of Superannuation Trustees (2017). *SuperRatings: Fee and Performance Analysis*. [online] pp.5-7; 13-15. Available at: <https://tinyurl.com/y9lywg53> [Accessed 25 Mar. 2018].

<sup>6</sup> Unpublished data

<sup>7</sup> The Australian Institute of Superannuation Trustees (2017). *SuperRatings: Fee and Performance Analysis*. [online] p18. Available at: <https://tinyurl.com/y9lywg53> [Accessed 25 Mar. 2018].

	<p>regulatory oversight and disclosure regime, the fee disparity (despite similar asset allocations) and the value of the sector compared to MySuper.</p> <p>If trustees are required to assess each product and determine if they are delivering outcomes, then there are incentives for poorly performing products or those with high fees to no longer be offered to members.</p>
<p><b>Legacy</b></p>	<p>A significant amount of superannuation assets held in legacy products.</p> <p>There is evidence that members in legacy products pay substantially higher fees than those in MySuper products.<sup>8</sup></p> <p>Furthermore, there is no requirement to produce a shorter Product Disclosure Statement (PDS) for legacy products, which makes it difficult for members in legacy products to compare performance, fees, and costs of the product compared to other contemporary products. This information asymmetry highlights the need for greater scrutiny.</p> <p>Research by Rainmaker also revealed that from 2014-2017 the retail sector delayed in transitioning members from legacy products to MySuper options- The cost of this <i>transition delay amounts to \$800 million in extra fees</i> being paid by retail MySuper members over the four years up until 2017.<sup>9</sup> This suggests that legacy products can have higher fees than MySuper, and thus need appropriate scrutiny.</p> <p>We submit that it is essential for a product level assessment to apply to legacy products because there are significant assets in legacy products, there is a limited oversight and disclosure regime, and there are significant fee disparities between legacy and MySuper products.</p>

<sup>8</sup> Rainmaker (2016). *Cost to retail fund members of delaying their MySuper transition*. [online] Rainmaker. Available at: <https://tinyurl.com/yaxydzt8> [Accessed 25 Mar. 2018].

<sup>9</sup> Rainmaker (2016), cited previously in this document.

### 1.5 Defined benefits

AIST recommends that defined benefit funds should be excluded. Defined benefit funds differ substantially from accumulation style funds, and the outcome that members receive differs depending on their employment, years of service and the retirement formula applied.

### 1.6 Post-retirement products

AIST continues to advocate for trustees developing a retirement incomes framework for their members and this framework should ensure benefits are passed back to members. APRA should provide clarity on whether an outcome assessment will be developed for post-retirement products.

### 1.7 Interaction with existing reforms

Proposed changes to the prudential framework should have regard to the outcomes of other reforms, especially when those reforms have the capacity to impact the implementation of the prudential changes.

#### ***Member outcomes bill***

The *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017* is currently before the Senate, where it has been since it was introduced on 14 September 2017. The Bill proposes to amend the SIS Act to require trustees to assess on an annual basis whether the outcomes that are being delivered by MySuper products are promoting the financial interests of MySuper member. In a submission to Treasury, AIST said that:<sup>10</sup>

- We support measures that strengthen the obligation on superannuation trustees to consider the appropriateness of their MySuper product offerings, provided this assessment does not reduce the existing legislative focus on the pursuit of optimal net returns.
- We support a two-tiered outcomes assessment with a primary annual MySuper outcomes assessment based on net returns and a secondary annual MySuper outcomes assessments having regard to other factors outlined in the Bill.
- The assessment should apply to all products, including Choice (not just MySuper products).

We are also concerned that if the Bill is passed, further consultation occurs to consider the effect on these proposals. The coverage of SPS and SPG 225 should be in line with the Bill (as passed) so that there is no increased and unnecessary administrative and regulatory burden.

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<sup>10</sup> The Australian Institute of Superannuation Trustees (2017). *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No.1) Bill 2017*. [online] p.4. Available at: <https://tinyurl.com/yausowtm> [Accessed 23 Mar. 2018].

### ***Design and distribution obligations and product intervention power***

In December 2017, Treasury released exposure draft legislation to introduce design and distribution obligations in relation to financial products. These obligations are aimed at improving consumer outcomes by ensuring that financial service providers appropriately promote suitable financial products to consumers of those products.<sup>11</sup> These obligations would require a ‘target market’ assessment for financial products, with an aim of ensuring that products are only issued and distributed to the assessed ‘target market’.

In February 2018, we outlined our support for the Bill but noted that it could be improved and made many recommendations.<sup>12</sup>

The industry needs clarity as to how the outcomes assessment as contained in the proposals and the target market assessments would interrelate. AIST recommends that this should be the subject of industry consultations prior to the proposals being implemented.

## **2. Strategic, business planning and expenditure obligations**

### **2.1 Introduction**

AIST supports both the need to have board approved strategic objectives and a business plan in place. However, we query the need to have these outlined in prudential standards. That being said, we believe the focus should, both within prudential standards and in practice, emphasise the need for a proper *process* as opposed to a prescriptive approach.

Draft revised SPS 220 requires RSE licensees to:

- Develop board-approved strategic objectives.
- Have a board approved written business plan in place to support the implementation of the fund’s strategic objectives. By way of example, the business plan must specify:<sup>13</sup>
  - Details of the activities that the RSE licensee will undertake to achieve their strategic objectives and expected outcomes.
  - How the RSE licensee will assess the outcomes of these activities.
  - Forecasted revenue from fees over next three years and the basis of fee calculation.
  - How the RSE will spend the revenue from the fees.

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<sup>11</sup> Exposure draft explanatory memorandum to the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018*, p. 6.

<sup>12</sup> The Australian Institute of Superannuation Trustees (2018). *Design and Distribution Obligations and Product Intervention Power – draft Legislation*. [online] Available at: <https://tinyurl.com/y7a377vm> [Accessed 23 Mar. 2018].

<sup>13</sup> Draft Prudential Standard SPS 220 *Risk Management*, Attachment A, section 3.

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- Have an expenditure policy that sets out how it ensures that fund expenditure is consistent with the fund's strategic objective.
- Develop a business case for each significant expenditure.

The Pensions Regulator in the UK has released guidance stating it is essential for trustees to develop and review a clear business plan to deliver good outcomes to members.<sup>14</sup> We agree with this assessment and support requirements for RSE licensees to have a business plan and expenditure policy in place to support the implementation of the RSE licensees' strategic objective.

It is important from a member perspective that the part of the business which is delivering retirement outcomes to them is required to undertake an outcomes assessment. Accordingly, we support the proposed requirements for RSE licensees that are part of a larger group to set strategic objectives and undertake business planning independently of the group objectives, to ensure priority is given to the interests of beneficiaries. This is necessary to ensure the interests of members of funds are prioritised over the interests of the corporate or group objectives.

Also, while we query the need to have strategic objectives and business plans outlined in prudential standards, we appreciate the need to have the basis for setting fees clearly articulated. This is an important component of the member outcomes test value proposition. We advocate that the basis for setting fees should also clearly apply to Choice products and investment options, which on average charge higher fees.

We conclude our remarks regarding strategic objectives and business plans by reiterating that the prescription contained within the proposals should be relaxed: As APRA notes in the Discussion Paper, many funds have these arrangements in place.

- Detailed prudential standards appear to run counter to the principle of prudential regulation.
- APRA's existing regulatory powers, and power to engage in micro-prudential regulation, is sufficient to address any deficiency in these areas.

APRA should also provide clarity on how business planning obligations operate in the context of lifecycle products.

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<sup>14</sup> The Pensions Regulator (2018). *21st Century Trusteeship*. [online] Available at: <https://tinyurl.com/y9x3u7w6> [Accessed 23 Mar. 2018].

### 2.2 Principles of prudential regulation

The requirements are highly detailed and relate to operational matters. This does not align with the principle of prudential regulation, which is to ensure that entities remain financially sound and able to meet their obligations to beneficiaries.

We submit that the specificity of the draft revised SPS 220 be relaxed, to give trustees greater freedom in establishing and monitoring the delivery of their strategic objectives.

### 2.3 Current legal framework and APRA powers

While we support the proposals in principle, the existing legal framework is robust and where APRA has concerns about a fund's decision making, it should utilise micro-prudential levers to address any perceived deficiency. Appendix A – 'APRA's regulatory toolkit' canvasses some of the power available to APRA in this regard.

Fund trustee decisions, particularly those on fund expenditure, are tightly controlled. By way of example, a decision to engage a service provider to provide a material business function requires the trustee to have regard to:<sup>15</sup>

- Prudential standards on outsourcing and conflicts of interest.
- SIS Act covenants.
- The best interest duty.
- The sole purpose test.
- The AIST Governance Code, which specifies that trustees who are signatories to the Code must ensure due process in all transactions and ensure that any related party transactions are performed at arm's length with full transparency and disclosure.
- The general law trust duty to act in the best interest of members.

We submit that APRA should clarify why it believes that the existing legal framework, in conjunction with their powers, is insufficient to address weaknesses in the practices of some RSE licensees.

### 2.4 Need for a reporting framework

In principle, we support the proposed enhancements to the superannuation reporting framework, including changes to Superannuation Reporting Standards (SRS) 330 and 331. Superannuation funds should be held to the highest standards of accountability and transparency, which includes reporting of fund expenditure. Notwithstanding this support there are several issues detailed below that must be addressed.

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<sup>15</sup> This is not an exhaustive list

Collecting more detailed expenditure data must not take priority over addressing the prolific gaps within the reporting framework for Choice products. The reporting standards that apply to MySuper products far exceeds that of Choice products. Here are some examples:

- Regulatory Guide 97 *Disclosing fees and costs in PDSs and periodic statements* is based on a lack of transparency, comparability, and does not deliver a level playing field outcome. Platform superannuation funds are not treated in the same way as non-platform superannuation funds (e.g. platforms are not required to aggregate fees and costs at point-of-sale PDS, managed investment schemes are treated differently to superannuation funds, and there is inconsistent treatment of fees and costs both within and between asset classes. The serious impact of this may be seen in a recent SuperRatings report<sup>16</sup>, which highlights that not all assets are impacted equally by the fee disclosure requirements and reinforces AIST's concerns about the current requirements and our emphasis on the need to focus on long term net outcomes. Significantly, the changes have seen fees for the not-for-profit median balance rise by nearly 32 per cent, compared to a rise in the median master trust of less than 10 per cent.
- The requirements for Choice dashboards has been deferred.
- APRA does not collect or publish statistics on Choice products equivalent to the extensive statistical collection derived from the MySuper reporting standards.
- There is no requirement to produce a shorter PDS for legacy products.
- APRA does not collect or publish statistics on legacy products equivalent to the extensive statistical collection derived from the MySuper reporting standards.

While we support greater disclosure of data in principle, we are unable to fully assess the proposal without knowing how APRA proposes to manage the data that is collected. This is a general comment, and applies to all requests for additional information, including those within the proposals. We ask that APRA provide clarification on essential questions such as:

- Objectives for data collection and reporting;
- Principles for determining the importance of calls for new data reporting;
- The relevance of the data being collected;
- How the data will be analysed and used;
- How confidentiality of certain data will be maintained;
- Data mapping and the need for agencies to justify why they require the data in a different format.

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<sup>16</sup> SuperRatings, *Fees in a post RG97 world*. [online] Available at: <https://tinyurl.com/ybhve3qt>. Accessed 5.4.2018

There are other existing issues regarding reporting to APRA which also must be resolved. These include the implementation of RG 97 (fees and costs disclosure), as well as the alignment of MySuper and Choice reporting. There are many ongoing reviews and regulatory reforms that impact the collection of data by APRA. The actual and likely impact of these reviews and reforms must be assessed in the context of the proposed reforms.

### **2.5 Expenditure reporting**

In principle, AIST supports the proposals to gain expenditure reporting. However, AIST has five concerns regarding the proposed expenditure reporting requirements:

#### ***Data reporting framework is needed to give clarity and transparency***

As mentioned above, there is a need to develop a data reporting framework. A data reporting framework could also be used to set criteria against which new requests for data may be assessed. While we support in principle the collection of more data, this needs to be placed within a transparent context. AIST recommends that there be further consultations to examine the possible development of a data reporting framework.

#### ***Data to enable benchmarking needs to be specified***

The development of such a framework could include an examination of what data is needed so that both APRA and superannuation funds are enabled to benchmark themselves against others.

#### ***Timely reporting of data***

Currently, superannuation funds provide a considerable amount of data to APRA, but reporting back to industry is at fund level and is not provided in a timely fashion. Our member funds have advised that currently, it is difficult to suitably use the APRA data given the lack of timeliness of reporting.

#### ***Related party costs must be identified***

Expenditure reporting should provide clarity regarding what costs are directly relating to a superannuation fund. For example, are other parts of a conglomerate cross-subsidising advertising costs for the superannuation fund. AIST has long called for the updating of APRA's 2010<sup>17</sup> report on the impact of related party costs. Without this clarity, benchmarking superannuation system costs, determining the efficiency of the system, and better enabling member outcomes determinations cannot be properly achieved.

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<sup>17</sup> Australian Prudential Regulation Authority (2010), Working Paper: Australian Superannuation Outsourcing – Fees, Related Parties and Concentrated Markets (12 July 2010).

### ***Consistency of categories is needed***

We both note and agree with APRA's concern that there are problems associated with the accuracy, comparability and depth in expense reporting. This uncertainty also has an impact on the ability to benchmark system costs and to properly conduct member outcomes assessments.

### **2.6 Insurance**

We support a requirement for RSE licensees to provide a simple opt out process for all insurance products. The industry is committed to ensuring high standards are applied by funds when providing insurance to members, as highlighted by the development and adoption of the Insurance Code of Practice by funds. Funds needed to state their intention to adopt the Code before 31 March 2018. We estimate that at least 75% of AIST members have either adopted- or are well advanced in the process of adopting - the Code.

There is merit in exploring whether it is possible to develop a standard opt out process for insurance products across the entire industry.

### **2.7 Status of the Member Outcomes Bill**

As outlined above, the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017* is currently before the Senate and there are similarities between the Bill and APRA's proposals. There is uncertainty within the industry on whether APRA can proceed with its reforms independent of the Bill passing Parliament and we welcome clarification on this issue.

Furthermore, if the Bill is passed in APRA should:

- Review the Bill and determine whether changes to the package of reforms are necessary; and
- Review the implementation timeframe and consider whether a longer timeframe is necessary for the measures to be implemented adequately.

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## Response to consultation questions

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### Table 1 Chapter 2 questions

***Amendments to SPS 220- Business Planning:***

- 1. Are there additional or alternative strategic and business planning requirements APRA should consider?***

AIST reiterates its support for funds needing to have strategic objectives and a business plan. While the list of requirements within draft SPS 220 are reasonable, we do query the need for such issues to be covered within prudential standards. That being said, we believe that the focus in SPS 220 should be upon *process*.

***Amendments to SPS 220- Expense Management:***

- 2. Are there additional or alternative expense management requirements APRA should consider?***
- 3. Is the concept of 'significant' expenditure in SPS 220 consistent with how RSE licensees currently undertake delegated expenditure decisions?***

AIST supports the approach of allowing funds to determine whether an expenditure is significant. AIST believes that the concept of 'significance' should align to the RSE's Risk Management Framework. Consequences (defined in terms of member numbers or funds under management) should be aligned to decision making including delegations, authority for accepting risks and decisions about risk modification activities. This is how risk management and strategic management are aligned in practice.

We also note that it seems that the current approach would not cover expenditures for outsourced operations – which would be a large expenditure for many funds. The meaning of 'significant' varies between funds and the complexity, size and business operations of the fund. It would be beneficial if APRA provided further guidance on the meaning of 'significant' expenditure, and AIST's preference is that it should be aligned with use in funds' Risk Management Frameworks.

### ***New SPS 225: Outcomes Assessment***

#### ***4. Are there additional factors or considerations that should be included in the outcomes assessment?***

As outlined above, it is essential that a consideration of long-term net returns be included in the outcomes assessment and for this to be given primary focus. AIST acknowledges that the value of net returns needs to be backed through the delivery of quality products and services.

At a minimum, an outcomes assessment should include consideration of the following factors. Where we have included factors which are not outlined in draft SPG 225, we have placed them in *italics font* for ease of reference:

- Returns, net of investment fees and taking into account risk (*primary focus*). Clarity is needed regarding the manner in which cash and other options should be assessed.
- Administration fees.
- Insurance cover and costs.
- The nature, and quality of the benefits and services being provided.
- The adequacy of an RSE licensee's governance and risk management frameworks and practices.
- *Fund sustainability (as opposed to 'scale of its business operations as' referenced in clause 38 of draft SPG 225).*
- *Scheme governance and management (e.g. professional advice to trustees and audit processes).*

The outcomes assessment must apply at a product level and apply to all MySuper, Choice and legacy products to ensure that underperforming or poorly designed products are identified and addressed.

As stated earlier in this submission, we agree with the proposals in that RSE licensees would be required to undertake assessments which reflect the structure of their businesses – including the range of products, investment options and sub-plans.

**Commencement:**

- 5. Will the proposed commencement date of 1 January 2019 provide RSE licensees appropriate time to prepare for implementation of SPS 220 and SPS 225? If not, why not?**

The ability of trustees to respond to the changes will partly depend on:

- The passage of the *Member Outcomes No. 1* bill.
- The outcome of APRA's post-implementation review of prudential standards.
- APRA's consultation on draft CPS 234 'Information Security'.
- Other regulatory reforms affecting issues such as governance or disclosure (for example the disclosure requirements regarding the Australian Financial Complaints Authority).
- Clarity regarding how the proposals will interact with the design and distribution obligation proposals.

**New SPG 221 and new SPG 225:**

- 6. Is there any additional guidance APRA should consider including in the new SPG 221 and SPG 225 to assist RSE licensees in meeting the requirements in SPS 220 and SPS 225?**

As outlined above, express alignment with a fund's risk management framework would be ideal.

Draft SPG 225 lists factors and metrics in paragraph 6 and 18, both of which include reference to assessing outcomes with reference to 'returns net of investment fees.' However, the two lists also include several other factors and metrics that an outcomes assessment could include.

The metrics and factors outlined in the SPG should be incorporated in the SPS, and long-term net returns should be clearly outlined as being the key factor to assess within the outcomes assessment. For example, it does not seem appropriate that criteria related to the fund's 'service quality'<sup>18</sup> is as important, to a member's future as long-term net returns.

The guidance also notes<sup>19</sup> that net returns relative to return targets is a key outcome for MySuper products. We agree with this observation; however, it is not clearly outlined that net returns are

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<sup>18</sup> Draft SPG 225 paragraph 6(d).

<sup>19</sup> Draft SPG 225 paragraph 20.

also a key outcome for Choice products and investment options, which is concerning. The guidance should clearly state that net returns key outcome for all members of all products and investment options.

***Amendments to existing prudential guidance:***

- 7. Has APRA incorporated in new SPG 221 sufficient guidance to enable existing SPG 221 and SPG 222 to be withdrawn?***
- 8. Does Circular No. III.A.4 remain relevant to industry?***

It is essential for all trustee decisions to be made in accordance with the sole purpose test in the SIS Act. The superannuation circular on the sole purpose test published by APRA in February 2001 is an important part of the regulatory framework.

The guidance should be updated and maintained to help ensure that all trustee decision making is made through the prism of the test.

AIST has considered the three options in the discussion paper, namely:

- Option one: retain existing strategic and business planning requirements in SPS 220 with no further alignment with CPS 220;
- Option two: issue new or amended prudential guidance on APRA's expectations about RSE licensee strategic and business planning and fund expenditure decision-making in the form of amendments to SPG 220 (or in the form of a new standalone prudential practice guide);  
or
- Option three: update the prudential framework by amending SPS 220 in respect of strategic and business planning, fund expenditure and alignment with CPS 220 and introduce new SPS 225, new SPG 221 and new SPG 225.

We agree that option three is the preferred mechanism.

**Table 2 chapter 3 questions**

***Look-through***

- 3. Drawing from experience gained from reporting investments data on a look-through basis, what material operational challenges and costs are envisaged from reporting expense information on a look-through basis?***
- 4. To what degree do you use bundled service arrangements? Are there material impediments for you in attributing or estimating the value of each component service in the bundle and, if so, how could they be addressed?***

We support the proposed enhancements to the superannuation reporting framework. Several issues have been canvassed above and these must be addressed for the proposals to satisfy the intended objective.

APRA should also conduct an in-depth analysis of related party costs, similar to the one undertaken in 2010, to understand the flow of trust monies.

***SRS 331.0- Updated Items:***

- 5. On SRS 331.0, do the roles listed on items 1-2 and expense types listed on item 4 provide a complete coverage of current industry arrangements? If not, what suggestions do you have for additions to the list?***

It is critical that the issues with superannuation fees and costs disclosure are addressed. There are a number of disclosure and reporting to APRA carveouts which need to be fixed. AIST accepts that these are longer-term projects, but they do significantly bear on the industry (and indeed the regulators) being able to either compare products and services or enable benchmarking the system. Addressing these issues would enable APRA to implement data reporting on fees and costs including for Choice and legacy products and investment options.

### ***Transition Timeframe***

- 9. If APRA were to change the reporting requirements as described in this chapter, what would be an appropriate transition period to enable you to implement these changes? If the transition needs would be different across different proposals, please specify this in your response.***

As outlined above, the transition timeframe will depend on:

- The passage of the *Member Outcomes No. 1 Bill*.
- The outcome of APRA's post-implementation review of prudential standards.
- APRA's consultation on draft CPS 234 'Information Security'.
- Other regulatory reforms affecting issues such as governance or disclosure (for example the disclosure requirements regarding the Australian Financial Complaints Authority).
- Clarity regarding the interaction between the proposals and the design and distribution obligations proposals.

## Appendix: APRA’s regulatory toolkit

This table outlines the powers that are provided to APRA through legislative instruments. It excludes powers that are contained in the suite of superannuation prudential standards.

**Table 2 – APRA powers contained in superannuation prudential standards**

APRA power	Detail of power
<b><i>Power to seek injunction</i></b>	APRA has the power to seek an injunction to restrain persons from engaging in, or proposing to engage in, specified conduct outlined in the SIS Act. <sup>20</sup>
<b><i>Suspend or remove a trustee</i></b>	APRA has the power to suspend or remove a trustee of a superannuation entity in circumstances, such as: <sup>21</sup> <ul style="list-style-type: none"> <li>• It appearing to APRA that conduct has been, is being, or proposed to be engaged by the RSE licensee may result in the financial position of the entity or of any other superannuation entity becoming unsatisfactory.</li> <li>• The RSE licensee breaching a RSE licence condition.</li> </ul>
<b><i>Disqualification</i></b>	APRA has power to disqualify individuals that are, or were, responsible officers of trustees. <sup>22</sup>
<b><i>Appointing acting trustee</i></b>	APRA can appoint an acting trustee on suspension or removal of a superannuation entity. <sup>23</sup>
<b><i>Infringement notices</i></b>	APRA can issue infringement notices if they reasonably believe that a SIS Act provision has been contravened and the provision is subject to the infringement notice regime. <sup>24</sup>
<b><i>Ongoing reviews of management and operation of entities</i></b>	APRA regularly reviews the management and operations of superannuation entities through reviewing various reports received by those entities under the law.

<sup>20</sup> *Superannuation Industry (Supervision) Act 1993* (SIS Act) s 315. All references in this section are to the SIS Act.

<sup>21</sup> SIS Act s 133.

<sup>22</sup> SIS Act s 126A (1) – (3).

<sup>23</sup> SIS Act s 314.

<sup>24</sup> SIS Act s 223A.

<p><b>Investigate</b></p>	<p>APRA can investigate an RSE licensee if they believe the financial position of the superannuation entity may be unsatisfactory.<sup>25</sup></p> <p>APRA can also require the trustee to appoint an individual to investigate the whole or specified part of the financial position of the entity and make a report on this investigation.<sup>26</sup></p>
<p><b>Directions power</b></p>	<p>APRA has the power to issue a direction to an RSE licensee if APRA has reasonable grounds to believe that the RSE has breached a condition of their licence.<sup>27</sup> Licence conditions include a requirement for the RSE licensee to comply with RSE licensee law, which includes the SIS Act, regulations, prudential standards and other legislation.<sup>28</sup></p> <p>APRA can also issue directions about acquiring or disposing of assets, or a freezing of assets if the entity’s conduct is likely to adversely affect the interests of beneficiaries.<sup>29</sup></p>
<p><b>Directions power – prudential standards</b></p>	<p>APRA can issue a direction to a RSE licensee if it has reasonable grounds to believe that the RSE licensee has not complied with prudential standards.<sup>30</sup></p> <p>APRA has power, enshrined in legislation, to make prudential standards relating to prudential matters. Prudential matters are widely defined.<sup>31</sup></p> <p>These powers effectively mean that APRA has a high degree of flexibility, and ability, to develop and enforce various requirements on RSE licensees.</p>
<p><b>Obligations on auditors and actuaries</b></p>	<p>There is a positive obligation on auditors and actuaries to inform the regulator in writing if any contraventions of the SIS legislation or the <i>Financial Sector (Collection of Data) Act 2001</i> (FSCDA) may have</p>

<sup>25</sup> SIS Act s 263 (1)(b).

<sup>26</sup> SIS Act s 257 (1)(a)–(b).

<sup>27</sup> SIS Act s 29EB (a)–(b)

<sup>28</sup> SIS Act s 29E(1)(a); s 10(1).

<sup>29</sup> SIS Act s 264 (1) – (5).

<sup>30</sup> SIS Act s 29E(1)(a); s 10(1).

<sup>31</sup> SIS Act s 34C.

	occurred. <sup>32</sup> This notification requirement ensures the regulator can act as soon as practicable if necessary.
<b>Power to approve a RSE licence</b>	APRA has the power to grant a RSE licence, provided specified criteria are met. <sup>33</sup>
<b>Power to impose additional conditions on an RSE licensee</b>	APRA has the power to impose additional conditions on RSE licensees, above minimum legislative conditions. <sup>34</sup>
<b>Powers related to licensing of trustees</b>	Part 2A of the SIS Act sets out APRA's broad powers and responsibilities regarding the licensing of trustees and includes: <ul style="list-style-type: none"> <li>• Power to grant or refuse a RSE license.<sup>35</sup></li> <li>• Power to impose additional conditions on RSE licensees at any time.<sup>36</sup></li> <li>• Power to vary or revoke licence conditions.<sup>37</sup></li> <li>• Power to cancel a RSE license.<sup>38</sup></li> </ul>
<b>Powers related to RSEs</b>	Part 2B of the SIS Act sets out APRA's powers regarding the management of RSEs and includes the power to: <ul style="list-style-type: none"> <li>• Register or refuse to register an RSE.<sup>39</sup></li> <li>• Cancel the registration of an RSE.<sup>40</sup></li> </ul>
<b>Powers related to MySuper</b>	Part 2C of the SIS Act sets out APRA's powers related to MySuper products and includes the power to:

<sup>32</sup> SIS Act s 129(3).

<sup>33</sup> SIS Act s 29D.

<sup>34</sup> SIS Act s 29EA.

<sup>35</sup> SIS Act s 29D; s 29DE.

<sup>36</sup> SIS Act s 29EA.

<sup>37</sup> SIS Act s 29FD.

<sup>38</sup> SIS Act s 29G.

<sup>39</sup> SIS Act s 29M.

<sup>40</sup> SIS Act s 29N.

	<ul style="list-style-type: none"> <li>• Authorise or refuse authorisation for an RSE licensee to offer a MySuper product.<sup>41</sup></li> <li>• Cancel a MySuper product authorisation.<sup>42</sup></li> </ul>
<p><b><i>Power to declare superannuation funds as public offer funds</i></b></p>	<p>APRA has the power to declare superannuation funds as public offer funds.<sup>43</sup></p>

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<sup>41</sup> SIS Act s 29T; s 29TE.

<sup>42</sup> SIS Act s 29U.

<sup>43</sup> SIS Act s 18(6).