29 March 2018

General Manager, Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority
Email: superannuation.policy@apra.gov.au

Dear Sir/Madam

RE: Submission on APRA discussion paper "Strengthening superannuation member outcomes"

BT Financial Group (BTFG), part of the Westpac Group, welcomes the opportunity to provide feedback on the discussion paper *"Strengthening superannuation member outcomes"* released by the Australian Prudential Regulation Authority (APRA) for public consultation on 13 December 2017.

Overall comments

BTFG is broadly supportive of the changes being proposed within the existing draft SPS 220 *Risk Management* and the new SPS 225 *Outcomes Assessment*, which are intended to improve practices across the superannuation industry in important strategic and operational areas.

It is important that the requirements proposed in SPS 220 and SPS 225 are principles-based and not overly prescriptive, to enable RSE licensees to implement the requirements in a manner that is appropriate to their particular structure and business operations.

Our comments and recommendations on key areas of the discussion paper and the proposed requirements in SPS 220 and SPS 225 are discussed below.

1. Deferral needed to commencement date

In our view, the proposed commencement date of 1 January 2019 will not provide RSE licensees sufficient time to effectively implement the revised requirements in SPS 220 and the proposed new requirements in SPS 225. We believe it would not be feasible to implement the changes before the requirements are settled given the significance of the proposed changes and the cost/difficulty involved.

BTFG strongly recommends that the commencement date for SPS 220 and SPS 225 be deferred for 18 months (i.e. to 1 July 2020) to allow the industry sufficient time to undertake the necessary enhancements to business processes and systems and to ensure that the implementation risks are minimised.

APRA is currently proposing to release the final requirements in mid-2018, which will only give the industry 12 months from the finalisation of the requirements to implement the changes. We note that at the time of lodging this submission, we do not yet have final legislation and regulations, which means the relevant measures in the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No.1) Bill 2017* could change and potentially have a material impact on the proposed prudential requirements.

In our view, the industry will need at least 12 months from the finalisation of the requirements for SPS 220 and SPS 225 to implement the relevant changes to business processes and systems.

BTFG recommendation 1

BTFG recommends that the commencement date for SPS 220 and SPS 225 be deferred to 1 July 2020, to allow the industry sufficient time to undertake the necessary enhancements to business processes and systems and to ensure that the implementation risks are minimised.

2. Implementation issues

One of the biggest concerns for BTFG (and likely others across the industry) is that significant implementation costs are incurred on legacy products/funds. In the case of BTFG, these legacy products/funds are in the process of being rationalised and migrated into our contemporary product set and have planned to execute a program of work related to this by July 2020. We believe that it would be counterproductive to implement the new requirements in SPS 220 and SPS 225 for legacy products/funds, given their imminent rationalisation. We believe better member outcomes would be created through the continuation of the rationalisation activities rather than diverting resources to implementing changes to processes and systems, including developing new reporting, for products/funds that in many cases have been closed for some time and will soon be migrated/terminated.

BTFG recommendation 2.1

BTFG recommends that implementation of the new obligations in SPS 220 and SPS 225 not be required for legacy products/funds where:

- there is a Board approved migration/termination/merger strategy in place, which has been reported to APRA; and
- the strategy is capable of execution in a realistic timeframe (within two years).

In addition, based on BTFG's current superannuation structure, and taking into account our recent experience in amending our systems and process to provide APRA reporting at the RSE level, our view is that the organisational resources that will be needed to implement the proposed new requirements in SPS 225 (which we believe will require reporting at product/offer level) will be significant, and will require a similar multi-year project approach costing an estimated $40 million.

BTFG recommendation 2.2

BTFG recommends that APRA continue its consultation with industry with a view to finding an implementation methodology that achieves APRA's intended outcomes without resulting in significant implementation costs for the industry.

3. Expense management

BTFG supports APRA's proposal to amend SPS 220 to require RSE licensees to establish and maintain a Board-approved expenditure policy that sets out how it will ensure that fund expenditure is consistent with its strategic objectives, and specifies the controls and approval processes for fund expenditure (by level and type of expenditure, including specific reference to unplanned expenditure).

In addition, BTFG supports the proposed requirement that RSE licensees must prepare a business case for each significant expenditure (whether planned or not), demonstrating that the expenditure has a clear purpose or objective, and closely monitor whether or not that expenditure has achieved the intended objectives.

However, we believe that further guidance from APRA is required around the level and type of expenditure that it would consider 'significant'. In our view, significant expenses should be limited only to those expenses that are recovered from members' accounts or RSE reserves.

For example, in the case of BTFG, RSE licensee entities utilise employees and resources of the Westpac Group under employee and resource sharing arrangements, or may have service provider arrangements which are bundled with another RSE licensee, other members of the BT Financial Group or the Westpac Group. Any costs relating to these arrangements may not be readily attributable to particular RSEs and particular members within an RSE because they relate to services that are common across a broader group. Where these costs are not expected or intended to be met directly from members' accounts or investment reserves within the RSEs we do not consider that they should be captured as 'significant' so as to require a business case.

BTFG recommendation 3

BTFG recommends that further guidance be provided by APRA in SPG 221 regarding the level and type of expenditure that it would consider 'significant'. In our view, significant expenses should be limited only to those expenses that are recovered from members' accounts or RSE reserves.

4. Look-through reporting of expenses

BTFG supports the principle underpinning APRA's proposals to implement look-through reporting of expense information, which is to improve transparency around fund expenditure and bring about a more consistent approach across the industry on the way RSE licensees categorise and report fund expenses.

However, while BTFG supports this principle there are some key challenges that in our view require further analysis and discussion before reaching a final decision.

BTFG's superannuation business comprises multiple RSE licensees and RSE products and forms part of the Westpac Group. As a large complex organisation, a significant portion of the expense base is managed by corporate core functions which attribute costs to subsidiaries through an allocation process. In our view, further allocation and categorisation of these expenses to an RSE level may present a challenge, particularly where allocations are not setup in a comparable structure. Reporting and categorisation of expenses at an RSE level would require refinement to the current allocation process, with the magnitude of work dependent on the level of look-through required.

Furthermore, we believe the benefit from the proposed look-through reporting needs to be weighed up against the cost of implementation to enable meaningful reporting at the required level of granularity. This is particularly relevant where legacy products/funds are in the process of being simplified and/or rationalised. In our view, the implementation of additional reporting requirements for these products would potentially delay the rationalisation and simplification timetable.

In section 2 above we recommend that legacy products/funds should be carved out of the implementation of the new obligations in SPS 220 and SPS 225 where there is a Board approved

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migration/termination/merger strategy and where this is capable of execution in a realistic timeframe (say within the next two years). However if a general carve-out for legacy products/funds is not possible, BTFG would ask that APRA consider making legacy products/funds exempt from the proposed look-through expense reporting requirements in the circumstances discussed above.

In addition, expense allocation is complex in organisations such as BTFG and will more than likely differ to other entities due to differing expense drivers and cost categories, making comparability between industry participants difficult. We therefore believe that the industry would benefit from clear guidance from APRA that can be applied by participants in implementing the approved policy, to ensure consistent application and comparable information is produced across the industry.

Unlike the fees charged directly to members (such as administration, trustee, investment management and member fees), the costs to the RSE licensees of providing these bundled services are met through a direct recovery of certain properly incurred expenses, where these can be allocated to an RSE (examples include the cost to the RSE of operational risk trustee capital and the APRA levy on the RSE). These amounts are described in the product's PDS, members' annual statements and the RSE's annual reports and financial statements, all of which are publicly available.

If the current level of information provided to members is not considered sufficient, we believe that this should be dealt with by enhancement to one of the above-mentioned disclosure documents (which are available to members), rather than via changes to the APRA reporting requirements.

BTFG agrees that the costs charged to members / the RSE should be disclosed and actively compared, alongside returns and other outcomes. The RSE licensee, whether "for profit" or "profit for members", should be required to disclose what it pays to related parties where the amounts are directly expensed to a fund rather than being met through retained profits of the entity. However, we believe the greatest benefit of look-through expense reporting would be in respect of "profit for members" funds. In a "for profit" entity it is irrelevant whether the service is provided in-house or sourced from an external provider. Where an entity calls itself "profit for members" there is a need to look-through further (i.e. to identify and report expenses paid to a third party or non-connected entity), to verify that it is justified in labelling itself as such.

We understand that APRA intends to undertake further consultation with the industry on the issue of look-through reporting of expenses. BTFG supports this intention and looks forward to working with APRA and the broader industry to develop a reporting methodology that achieves APRA's desired outcomes without resulting in significant implementation costs for the industry.

BTFG recommendation 4

BTFG recommends APRA proceed with its proposed further consultation with the industry to develop and implement a workable and cost-effective methodology for RSE licensees to report expenses to APRA on a look-through basis.

In addition, we recommend that legacy products/funds be exempted from the proposed look-through expense reporting requirements where there is a Board approved migration/termination/merger strategy and where this is capable of execution in a realistic timeframe (say within the next two years).

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5. Outcomes assessment

BTFG supports the importance of ensuring a link between fund actions and member outcomes and believes that a focus on overall outcomes for members, beyond simple net returns and the level of fees and costs, will help to drive long-term improvements across the industry. The outcomes assessment should also assist APRA to identify and lift the performance of the subset of RSE licensees that have inadequate strategic and business planning practices, governance and risk management frameworks.

We therefore support the requirement in draft SPS 225 that an outcomes assessment be conducted annually by RSE licensees, within 12 months of the previous assessment, at a point in time during the year that enables the outcomes of the assessment to be reflected in the annual review of the RSE licensee's business plan.

In our view, APRA should play a central role in broadly setting the methodology that funds should be using to undertake their outcomes assessments. We believe it would be helpful for the industry if APRA was to provide further guidance on this, to ensure that the methodologies used by each RSE licensee to develop and undertake their outcomes assessments are consistent across the industry, particularly if RSE licensees will be required to compare the results of their outcomes assessments with those of other RSEs as is being proposed.

Once a common basis for undertaking the outcomes assessment has been set by APRA, it will be more straightforward for RSE licensees to design their assessments, giving consideration to the factors listed in paragraph 8(e) of SPS 225 and the metrics listed in paragraph 18 of SPG 225.

Once the annual outcomes assessments have been undertaken, RSE licensees could then provide APRA with a Board-approved 'statement of attestation' that it has considered the results of its outcomes assessment. This 'statement of attestation' would be supported by more detailed results of the outcomes assessment, together with details regarding any actions the RSE licensee plans to take to remedy any perceived deficiencies (including any changes it plans to make to its strategic and business plans).

BTFG recommendation 5.1

BTFG recommends that APRA plays a central role in setting in broad terms the methodology that funds should use to undertake their outcomes assessments, to ensure there is consistency across the industry. It would also be helpful if APRA was to provide guidance on how RSE licensees should demonstrate to APRA that they have given full consideration to the results of the assessment, such as the by way of an annual 'statement of attestation' (as discussed above).

Additionally, we note that paragraph 8(d) of SPS 225 requires an RSE licensee to calculate each of its metrics and compare its results against its own benchmarks and targets (absolute basis), and to compare these results with objective benchmarks and targets of other RSEs (relative basis). With respect to the relative basis comparison with other RSEs, BTFG is concerned that unless all RSEs are using the same methodology in undertaking their outcomes assessments, this relative comparison may not be appropriate as it will not generate meaningful and consistent outcomes. Also, in the absence of all RSE licensees having moved to APRA's proposed enhanced reporting regime for at least a few years, there will be insufficient data available for RSE licensees to undertake meaningful comparisons of their results with those of other RSEs.

As stated above, in order for the results of these comparisons to be meaningful, BTFG believes that APRA must firstly play a central role in ensuring that the methodologies used by each RSE licensee to develop and undertake their outcomes assessments are consistent across the industry. In addition to this, we believe sufficient time should be allowed to pass in which RSE licensees report their results on an absolute basis, before a requirement is introduced for RSE licensees to conduct a relative basis comparison of their results with those of other RSEs.

BTFG recommendation 5.2

BTFG recommends that paragraph 8(d) of SPS 225 be amended such that RSE licensees are initially (i.e. for the first few years the from commencement of SPS 225) only required to calculate each of its metrics against its own benchmarks and targets (i.e. on an absolute basis). The requirement for RSE licensees to compare the results of their outcomes assessments with those of other RSEs (i.e. on a relative basis) should be deferred for at least a few years from the commencement date of SPS 225, until sufficient data is available for meaningful comparisons to be undertaken.

6. SPS 250 Insurance in Superannuation

In relation to default life and disability insurance policies provided through superannuation, BTFG supports the Government's intention, and APRA's resulting proposal to amend SPS 250 *Insurance in Superannuation*, to require RSE licensees to provide simple and straightforward opt-out processes.

As a founding member of the ISWG, BTFG has been involved in the work to develop the Insurance in Superannuation Voluntary Code of Practice (the Code), which includes initiatives to assist fund members to more easily understand and make changes to their insurance cover.

We strongly support the Code and look forward to participating in APRA's future consultation to update SPS 250 to establish consistent opt-out practices across the industry.

BTFG recommendation 6

BTFG recommends that APRA proceed with its proposed consultation to amend SPS 250 to require RSE licensees to provide simple and straightforward opt-out process for default life and disability cover provided through superannuation.

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We would be pleased to discuss any element of our submission with APRA.

Yours sincerely

Melinda Howes
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BT Financial Group