



SUBMISSION

Productivity Commission draft report: Superannuation efficiency and competitiveness

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Introduction

The Australian Prudential Regulation Authority (APRA) is the prudential regulator of the Australian financial services industry.¹ APRA was established on 1 July 1998 and is largely funded by the industries that it supervises.

APRA supervises a wide range of superannuation funds under the *Superannuation Industry (Supervision) Act 1993* (SIS Act); these are known as registrable superannuation entities (RSEs). Trustees of RSEs must be licensed by APRA under the SIS Act as a registrable superannuation entity licensee (RSE licensee).² A register of RSE licensees and RSEs is available on the APRA website.³

APRA also collects data on the financial sector both for its own uses and on behalf of the Reserve Bank of Australia and the Australian Bureau of Statistics. APRA uses data from the institutions it supervises as a vital input into its assessment of risks in these institutions and in the financial sector more generally.

APRA requires all regulated entities, under the *Financial Sector (Collection of Data) Act 2001*, to lodge a range of returns, typically on a quarterly or annual basis depending on the nature of the data collection. Using this data, APRA produces regular publications that include information on the financial position and other aspects of all APRA-regulated industries, including the superannuation sector.

APRA-regulated institutions currently hold \$6.3 trillion in assets for Australian depositors, policyholders and superannuation fund members. At 31 December 2017, the APRA-regulated superannuation industry held assets totalling \$1.7 trillion.

¹ APRA oversees banks, credit unions, building societies, general insurance and reinsurance companies, life insurance companies, private health insurers, friendly societies, and most of the superannuation industry.

² The two main types of superannuation funds that are exempt from APRA supervision are: 19 public sector superannuation funds under the responsibility of relevant Federal, State or Territory Governments which are exempt from prudential supervision unless they have opted to be supervised by APRA; and self-managed superannuation funds that are regulated by the Australian Taxation Office.

³ Register of trustees available at <https://www.apra.gov.au/register-superannuation>

Chapter 1 - Member outcomes

The Commission emphasises that the key responsibility of the superannuation sector and its stakeholders is to deliver quality outcomes to all members.

*'The super system exists to support its members in retirement. As such, the outcomes delivered to members matter above all else.'*⁴

This focus is closely aligned with APRA's industry strategy for superannuation - to engender a mature and transparent industry which delivers quality member outcomes and is appropriately positioned for future effectiveness, resilience and viability in a competitive environment. APRA is pursuing this strategy through amendments to the prudential framework for RSE licensees and its supervision activities.

Prudential framework changes

In 2012, the Government's Stronger Super reforms provided APRA with the power to make prudential standards applying to the superannuation industry. This allowed APRA to substantially harmonise the prudential frameworks across all APRA-regulated industries, whilst still recognising the unique characteristics of the superannuation system.

APRA's prudential standards represented a significant shift in the regulatory philosophy for the industry, from being substantially compliance-focused to the principles-based, outcomes oriented approach enabled by prudential standards. The industry has put significant effort into implementing the new prudential standards over the last five years, and that effort has translated into satisfactory progress in lifting industry practices. However, that progress is variable across the industry, with some trustees taking significant strides towards better practice while others have (in some cases) considerable room for improvement. Similarly, the quality of outcomes being provided for members varies widely across the industry.

In December 2017, APRA issued a consultation package outlining APRA's proposals for further prudential reform to address gaps relating to the adequacy of strategic and business planning practices.⁵ These reforms, which are expected to be finalised in September 2018, will require RSE licensees to set strategic objectives, have rigorous business planning processes and to undertake regular assessments of outcomes being delivered to members, which will then inform future strategic objectives and business planning processes. These reforms reflect APRA's observations of where improvements in industry practices are needed, based on its supervision activity and engagement with RSE licensees over recent years.

⁴ Page 7 of the Productivity Commission's Draft Report Overview issued April 2018.

⁵ APRA Discussion Paper, *Strengthening superannuation member outcomes*, 13 December 2017.

APRA's outcomes assessment

APRA's proposals, set out in its December 2017 consultation package, require an RSE licensee to undertake an annual assessment of outcomes being provided to members as a component of the annual review of its business plan.

APRA's outcomes assessment will apply to all members across the entirety of an RSE licensee's business operations. APRA expects an RSE licensee to assess the outcomes being provided to members within its RSE(s) and how the decisions made in relation to its operations affect these outcomes.

Broadly, APRA expects an RSE licensee would, as part of the assessment:

- a) articulate the outcomes it seeks for members, and the metrics it will use to measure whether those outcomes have been provided;
- b) undertake an assessment of outcomes using these metrics, in absolute and relative terms;
- c) determine the impact that features of their product offering and business operations have had on performance relative to relevant metrics; and
- d) identify and pursue opportunities for improving outcomes, where the cost-benefit assessment justifies doing so.

In undertaking the outcomes assessment, an RSE licensee would be expected to determine whether their overall product offering is appropriate and delivering quality member outcomes. This will include consideration of the complexity and costs associated with the range and number of investment options that are offered and the impact that maintaining products that are no longer available to new members (legacy products) has on both members holding those products and the RSE licensee's capacity to manage those products. The outcomes assessment is intended to improve product offerings across the industry, thereby improving outcomes to members.

APRA's proposals are deliberately principles based, which allows RSE licensees the flexibility to undertake the assessment in a manner that suits the size, nature and complexity of their business operations. This flexibility provides the RSE licensee discretion, subject to some key requirements, as to how to assess the outcomes being provided to members. APRA expects that many RSE licensees will focus on financial returns in assessing the delivery of outcomes, particularly for default membership cohorts. However, APRA's long-held view, which is reflected in its proposals, is that a focus on financial returns to the exclusion of other considerations is not sufficient as it disregards other key components of the member offering. For example, an outcomes assessment that incentivises a focus on net investment performance to the detriment of key areas of the sound operation of an RSE licensee, such as the adequacy of its governance and risk management frameworks, may compromise outcomes for members in the longer term.

APRA expects RSE licensees to continually review and enhance their assessment approach over time, to ensure it remains fit for purpose. These expectations will be included in a prudential practice guidance accompanying the new prudential standard.

APRA's supervision of these new requirements will initially focus on how effectively RSE licensees have embedded the new requirements into their business operations and practices, and the progress of RSE licensees in delivering better outcomes for members. APRA expects that as the changes are implemented and better practice is observed, the supporting prudential guidance will be regularly updated.

Supervisory activities

Since APRA's prudential standards were introduced in 2013, APRA's initial supervisory attention was on the implementation of those standards and ensuring that RSE licensees were putting in place appropriate frameworks, policies and processes to comply with them.

APRA's supervision focus then shifted to assessment of how effectively regulated entities had embedded these frameworks, policies and processes into their business operations. APRA undertakes these assessments at an individual entity level and also at an industry level, for example through thematic reviews. Most recently, APRA has been seeking to shift RSE licensees' mindset from one of simply meeting compliance requirements to one that is focused on better practice and the delivery of quality member outcomes. This helps ensure that RSE licensees are positioned for future resilience and viability in an increasingly competitive environment.

As outlined above, in response to weaknesses identified from its supervisory activities, APRA's current focus in terms of both its supervision and prudential policy activities, is on ensuring that entities have sound strategic and business planning processes in place that are centred on the delivery and assessment of member outcomes.

APRA is also continuing its supervisory attention on those RSEs that have been identified as poorer performers, with a view to determining the cause of shortcomings in the identified areas and requiring them to develop a robust and implementable strategy to address identified weaknesses within a reasonably short period. APRA has met with all of the 28 funds that were identified, and to date 13 of those funds have agreed to restructure or exit the industry. Another 4 of those funds have revised their fees with a view to improving member outcomes. Two of the funds are no longer considered to be outliers following further analysis and the remaining nine are in continuing discussions with APRA.

Investment performance

The Commission indicates that delivering strong investment returns (net of all fees and taxes) is the most important way that the system contributes to delivering the best possible retirement incomes. Investment performance is therefore the primary consideration in assessing whether a product is performing to the benefit of members.

Whilst APRA agrees that investment performance is core to RSE licensees delivering quality outcomes to members, there are a number of challenges in undertaking and comparing performance across RSEs. In assessing investment performance, APRA encourages RSE licensees to assess performance at a fund, product and option level, using a range of metrics and different time periods, and referencing different performance benchmarks. Further, it is important that performance is considered across different dimensions; on a risk-adjusted

basis, and in both relative and absolute terms – not just by reference to peer comparisons. The Commission’s benchmark portfolios provide a useful reference point as RSE licensees continue to review and enhance their approach to investment performance assessment.

MySuper products are more readily comparable than choice products, and substantial data about MySuper products is reported to and published by APRA. The assessment of single investment strategy MySuper products is more straightforward than lifecycle strategy MySuper products. APRA considers that appropriate design of lifecycle strategies is imperative in delivering appropriate outcomes to MySuper members, particularly with regards to ensuring that these products do not de-risk unnecessarily early. The inherent complexity of lifecycle products also makes it difficult to assess and compare performance with other MySuper products. Whilst their suitability as a default product is a matter for government, APRA intends, in the interim, to consider whether additional guidance should be provided about better practices in lifecycle product design and performance assessment to assist industry in this regard.

The combination of the heterogeneity in the choice segment, the number of options available in the market and the more limited data currently available makes it considerably more complex to assess investment performance in the choice sector. Nevertheless, RSE licensees have access to a range of data with respect to their choice offerings which should enable robust member outcomes assessments to be undertaken.

Offering insurance within superannuation

In recent years APRA has had a significant focus on the sustainability and suitability of insurance offerings by RSE licensees and life insurers. Insurance arrangements offered through superannuation had become increasingly complex and costly in an environment of lower investment returns, constrained contribution levels and increased policyholder awareness of insurance. These factors contributed to profitability pressures for insurers and exacerbated the tension between providing insurance that meets members’ needs while also ensuring that there is not undue erosion of member outcomes in retirement.

APRA has therefore communicated the need for RSE licensees and insurers to take steps to review current insurance arrangements to ensure they remain sustainable into the future and that members’ reasonable expectations are met.⁶ In particular, APRA has noted the need to review the role, level and design of default and choice insurance offerings; address the issue of unnecessary multiple accounts with insurance; ensure processes for assessing whether there is undue erosion of member outcomes in retirement are robust; review underlying insurance processes, terms and conditions; and enhance communication with members in relation to insurance.

APRA’s concerns are consistent with the issues identified by the Commission relating to the offering of insurance through superannuation, particularly in the context of default members. APRA supports the intent of the draft recommendations on insurance that are designed to protect members, particularly young members and those members with small account

⁶ See for example Helen Rowell’s speech, [APRA update: What can you expect in 2018](#).

balances, from the negative impacts of unnecessary multiple insurances and poor value policies.

The Government's Protecting Your Superannuation Package also addresses some of these issues. APRA supports the policy intent of the measures contained in the Bill, particularly those aimed at improving member outcomes by reducing the inappropriate erosion of members' retirement savings.

Under APRA's outcomes assessment, an RSE licensee will have to give consideration to the value of insurance provided to its members. RSE licensees will be expected to demonstrate how the design, level and cost of insurance is appropriate for different member cohorts, including that it is not inappropriately eroding retirement outcomes. APRA expects that RSE licensees will gain insights from the outcomes assessment process to critically examine both the type and level of cover made available to members, particularly default members.

APRA welcomes the development of the Insurance in Superannuation Voluntary Code of Practice (the Code) and considers that many of the minimum benchmarks in the Code will support the industry achieving better insurance outcomes for members over time. APRA will work with ASIC to monitor adoption of the Code across the sector over the remainder of 2018, including how RSE licensees seek to embed the Code within their insurance strategies.

However, APRA is wary of suggestions to prescribe the Code in the list of MySuper authorisation criteria, as the Code may change over time.

In implementing the Code and any legislative changes resulting from the Government's Protecting Your Superannuation Package, RSE licensees will need to assess and respond to the potential impacts on their members. It is likely that the removal of members from the 'default' insurance pool, together with the removal of members with inactive accounts, will create upward pressure on premiums for the remaining insured members. It is important that these changes are implemented in a considered and effective manner that seeks to mitigate to the extent possible any unintended or adverse outcomes for members. To achieve this, RSE licensees will need to work closely with their administrators and insurers.

APRA welcomes the Commission's proposed review of insurance after sufficient time to allow industry to respond to the implementation of the Code and the proposed legislative reforms.

Chapter 2 - Improving the default system

The default system should be designed such that members who cannot or do not wish to engage with their superannuation have their superannuation contributions placed in products that will deliver quality outcomes over the long term.

APRA agrees with the principle that members should be defaulted into an RSE only once in their working life, and can readily move their superannuation with them as they change employers.

APRA does not have a view as to the number of funds which should be permitted to accept default contributions. Rather, all MySuper products should meet appropriate standards and deliver quality outcomes for their members. In this regard, APRA welcomes the Commission's support for the Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017 (Member Outcomes Bill) as a means to improve the quality of existing MySuper products.

Specifically, the Member Outcomes Bill seeks to introduce an outcomes test, whereby RSE licensees annually determine whether their MySuper product is meeting the best interests of their members, and must annually compare their MySuper product against others in the market based on fees, returns, risk and other metrics. These changes, if implemented, are expected to improve the quality of existing and new MySuper products, and hence provide better outcomes for members of these products over time.

The Bill also includes enhanced directions powers for APRA, similar in scope to the powers that are in place in other APRA-regulated industries. This would provide APRA with critical powers for dealing more effectively with underperforming funds in a timely manner, including if needed the ability to direct RSE licensees of underperforming funds to transfer their MySuper members to another fund. APRA's experience is that having stronger powers supports the achievement of enhanced supervision outcomes, usually without needing to resort to the use of those powers.

Under the Commission's proposals, it will be important that the criteria for determining which products should be shortlisted are carefully designed to ensure they focus on all aspects that are important to the delivery of quality member outcomes. The factors proposed in the Member Outcomes Bill for such an assessment are a reasonable starting point for developing the criteria and – importantly – would ensure that factors other than just investment performance are considered.

The Commission suggests that RSE licensees that fail to meet these conditions – or persistently and materially underperform an APRA-determined, tailored investment benchmark – should have their MySuper authorisation revoked. Whilst APRA agrees that persistent underperformance provides a strong ground for removing the ability to accept default contributions, APRA cautions against using any single measure as a sole determinant of an RSE licensee's ongoing MySuper authorisation.

However, APRA considers that any fund persistently underperforming against a broad range of metrics for a prolonged period of time cannot reasonably argue that it is delivering quality

outcomes to its members. Further, APRA's proposed outcomes assessment seeks to enable both RSE licensees and APRA to identify factors causing underperformance early on and put in place strategies that would mitigate the risk of persistent underperformance.

Managing the transition

APRA supports the intention of many of the Commission's findings to drive better outcomes which, if adopted by Government, will lead to fundamental changes in the industry, particularly the allocation of default contributions.

Given the potential scale of change, it is important that the proposals are carefully implemented so as not to jeopardise the experience of, and outcomes for, members. APRA's view is that whilst there will be significant impacts in the medium to long term for individual funds that lose default status, these impacts could, with adequate transition arrangements, be managed at an individual RSE licensee level without causing undue instability or material adverse impacts for members.

APRA expects that the implementation of the Commission's proposed new model of allocating default contributions to a shortlist of funds is likely to have limited immediate impact on any RSE, allowing sufficient time for the RSE licensee to change strategic direction to reflect the change in their business operations, including potentially improving the delivery of member outcomes and competing to regain default status. In particular, APRA has analysed the potential change in an RSEs' net cash flow ratios over a five year period as a result of loss of the estimated share of the 'first-timer pool' of default contributions, and the loss of both the first timer pool and the 'turnover pool' of default contributions. This analysis indicated that the estimated short term impact of the loss of the first timer pool and the turnover pool of default contributions would be limited for most RSEs, suggesting that RSE licensees would have some opportunity to develop and implement strategies to mitigate potential impacts and ensure appropriate outcomes for members of the RSE.

APRA's estimates, however, cannot accurately measure the consequential impacts that may occur as a result of possible loss of default status, such as loss of contributions or increased rollovers out of the RSE by existing members. They also do not take account of the cumulative impact of the Commission's draft recommendations or other reforms to be implemented, for example, the measures in the Government's Protecting Your Superannuation Package.

While APRA does not expect the Commission's recommendations to lead to broader system instability, there would nevertheless be a need for APRA to work with individual RSE licensees to ensure they appropriately addressed strategic issues, including considering whether an orderly wind-up of the impacted RSE may be the most appropriate course of action.

Passage of the proposed APRA directions power will assist significantly in APRA's ability to resolve issues in a timely manner with RSE licensees that are consistently underperforming.

Chapter 3 - Enhancing fund governance

A number of the Commission's recommendations focus on improvements to the quality of RSE licensee governance. APRA has recently completed two targeted thematic reviews across the superannuation industry, focusing on board governance practices and related party arrangements with reference to the implementation of APRA's 2013 prudential standards.⁷ The Draft Report has highlighted findings that are consistent with APRA's thematic reviews.

Governance practices

APRA agrees with the Commission that board governance requires improvement in a number of areas. These areas are consistent with APRA's recent thematic review findings relating to board composition, appointments and assessments of board performance.

APRA's long-held view is that the appointment of directors able to bring new and objective perspectives to board deliberations, including the appointment of independent directors, can result in improvements to the quality of decision-making. Additionally, APRA continues to support the Government's proposed amendments to require a minimum of one-third independent directors and an independent chair on superannuation boards.⁸ This will allow the appointment of directors from a broader pool, so that boards have the necessary skills, capabilities, experience and diversity of views to enhance decision-making and better meet the current and future needs of their members.

Importantly, the proposed amendments will ensure all boards have a meaningful proportion of directors free from association with related entities – whether that is a parent organisation within a retail group or a nominating member or employer representative body of an industry fund – so there is adequate objectivity and challenge in decision-making, and more effective conflict management.

A number of RSE licensees use independent experts to support decision making at the board level. Whilst APRA does not object to the use of such experts, it does expect boards to critically examine whether having to use independent experts might signal a skill deficiency at board level that might be better addressed by appointing board members with the requisite skills and experience, potentially from beyond the usual pool of nominee directors.

APRA agrees with the Commission that developing and using skills matrices will help boards achieve the appropriate composition for their future strategic direction. APRA encourages RSE licensees to use such matrices to assist them in complying with the requirement to have an appropriately skilled board and to support compliance with *Prudential Standard SPS 510 Governance* and *Prudential Standard SPS 520 Fit and Proper*. APRA supports the publication of the skills matrices that are developed by RSE licensees, and information on how they are used in board appointment processes. However, APRA would have some reservations about mandating public disclosure of the assessment of individual director (rather than collective

⁷ Link to thematic letters: [Board Governance thematic review](#) and [Related party arrangements thematic review](#)

⁸ Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017

board) skills and experience. This may in fact work against the robustness of such assessments as directors (and boards) are unlikely to wish to be identified as lacking in needed skills and experience. What is most important is board's having in place a robust process that seeks to ensure the board as a whole has the requisite skills and experience and being able to demonstrate that process is effectively implemented.

The prevalence of outsourcing in the superannuation industry and its centrality to RSE licensees' business operations makes the management of service provider relationships critical in ensuring the delivery of appropriate member outcomes. This is particularly the case where an outsourced service provider is considered to be a related party of the RSE licensee.

APRA's thematic review into the management of related party arrangements found that for the sampled RSE licensees there have been improvements in the governance and management of related party arrangements since the conflicts of interest thematic review, with a number demonstrating effective approaches to managing related party service provider arrangements. However, areas for improvement were also identified. Mixed practice was observed in RSE licensees' decision making on engaging a related party provider. Areas for improvement included the analysis of the materiality of the arrangement and being able to demonstrate that such arrangements are conducted on an arm's length basis and in the best interests of members, including through utilising rigorous market testing or benchmarking. This issue has been communicated to RSE licensees and will be a focus of APRA's supervisory activities.⁹

APRA will consider, as part of its post-implementation review of the superannuation prudential and reporting frameworks (currently underway), reflection of the Commission's recommendations on governance in the prudential framework, as appropriate and taking into account relevant legislative provisions.

Fund mergers

The Commission makes a number of recommendations designed to respond to the failure of funds to merge where this would be to the benefit of fund members. These recommendations focus on providing information to APRA and increasing public transparency about merger activity.

A successor fund transfer (SFT) is the mechanism that RSE licensees utilise to give effect to a merger of different RSEs. APRA does not have a formal approval role in relation to SFTs and there is no requirement for RSE licensees to notify APRA when contemplating an SFT. Where an SFT is contemplated, under the SIS Regulations both the receiving and transferring RSE licensees must be satisfied that the transferring members' rights in respect of the benefits in the successor fund are equivalent to their rights in respect of the transferring RSE (equivalent rights).

⁹ [Related part arrangements thematic review letter](#).

Prudential Practice Guide SPG 227 *Successor Fund Transfers and Wind-ups* (SPG 227)¹⁰ explains that the assessment of 'equivalent rights' means that the members' rights in the receiving RSE are required to be equivalent, but not equal, to their rights in the transferring RSE and therefore can be assessed by both RSE licensees on a 'bundle of rights' basis.

This assessment should consider a range of factors, including members' best interests, and also take a longer-term view, rather than be only a point in time assessment. The equivalent rights assessment adds complexity to the merger process, and involves considerable analysis by the respective RSE licensees, but in APRA's view it does not represent a significant impediment to RSE licensees contemplating and undertaking mergers.

Where APRA is notified that an RSE licensee is contemplating a merger via an SFT, APRA will generally engage with the relevant RSE licensees throughout the merger process. The focus of APRA's engagement is primarily to be satisfied that an appropriate approach is being taken by the respective RSE licensees to the assessment of members' equivalent rights and assessing whether the merger is in the best interests of members of both RSE licensees. APRA also seeks to be satisfied that the operational aspects and risks associated with the merger are being effectively managed by each RSE licensee.

The current legislative settings assume that a superannuation trust can be readily excised, without consent from members, from the RSE licensee and a new trustee appointed. The modern superannuation system, however, requires RSE licensees to have a far more active and member-focused approach to managing the RSE in a manner similar to a corporate financial services organisation than might be the case in a more traditional trust model. Additionally, APRA's prudential framework focuses on the concept of the RSE licensee's business operations in recognition of the connection between the RSE licensee and its funds. The combination of active RSE licensee management of RSEs and the prudential settings means that there are likely to be issues to be addressed that were not envisaged when the legislative provisions relating to mergers were established.

Some the issues that must be considered to achieve a successful merger of RSE licensee business operations include:

- the rights of RSE licensee shareholders;
- appointments to board and key management positions;
- transaction costs, including executing the merger and the extent to which contracts with third party providers will have to be renegotiated;
- differences in culture or institutional philosophy in key areas (such as investments and insurance); and
- effective integration (or migration) of relevant operational systems and processes.

As noted earlier, APRA has limited regulatory capacity to influence the merger decision between RSE licensees. The proposed legislative directions powers would allow APRA to respond in a targeted way where one or more RSE licensees decides not to proceed with a merger which would clearly be in the interests of members.

¹⁰ To assist RSE licensees with the process for undertaking an SFT, APRA has issued Prudential Practice Guide SPG 227 *Successor Fund Transfers and Wind-ups* (SPG 227). SPG 227 was issued in July 2017, replacing older guidance, and provides a non-exhaustive list of considerations for RSE Licensees when determining the impact on members and whether a merger may be appropriate

APRA recognises that capital gains tax (CGT) may in certain circumstances be a barrier to fund mergers and removing CGT from fund mergers may make it easier for RSE licensees to recognise the benefits of merging with other funds.

APRA supports draft recommendation 6 regarding the reporting of attempted mergers to APRA, including detailed reasons for mergers that did not proceed, noting that APRA's prudential framework could be amended to require such reporting. APRA already has access to information about possible mergers through the ordinary course of supervision; however the draft recommendation would ensure that such information is provided in a more routine and structured way. When considering the merits of this recommendation, however, it is worth noting that it would be highly unlikely for an RSE licensee to volunteer self-interest as the reason behind a decision not to merge. It is, though, likely that the onus of having to more formally disclose information pertaining to a failed merger attempt may also serve to dissuade RSE licensees from choosing not to proceed with a merger that would clearly benefit members.

The Commission also recommends that APRA recast the guidance in *Prudential Practice Guide SPG 227 Successor Fund Transfers and Wind-ups* (SPG 227) relating to equivalent rights if legal impediments to fund mergers remain over the coming years. As a matter of course, APRA reviews standards and guidance in its prudential frameworks to ensure they remain relevant and effective. Accordingly, APRA will review SPG 227 in due course, noting that APRA's ability to provide guidance on the equivalent rights test is limited to the operation of that test in the law.

Chapter 4 - Regulatory architecture

Thorough prudential standard making powers and the power to authorise RSE licensees to offer MySuper products, APRA is necessarily actively involved in regulation and supervision of the behaviour and practices of RSE licensees and other agents involved in the superannuation industry. However, APRA does not agree with the Commission's draft finding that there has been an increase in the overlap with ASIC's responsibilities, resulting in poor accountability and lack of strategic regulation.

APRA's approach to its engagement with the superannuation industry follows very closely the steps described in the Commission's Draft Report, of identifying issues, having them addressed, and communicating about them. APRA undertakes strategic regulation and supervision to address practices of concern. However APRA's focus is on pre-emptive steps rather than ex post facto remedial action, and where possible achieving sound prudential outcomes through a range of supervisory tools and actions rather than formal enforcement measures. Because APRA works closely with regulated entities, it is well positioned to identify practices or risks of practices that may have an adverse impact on members' best interests, and seek to ensure that the RSE licensee takes steps to address these. The overriding principle that informs any decision as to the action to be taken will be the members' best interests.

APRA's view is that general deterrence has an important role to play in ensuring compliance by superannuation entities with the obligations and covenants imposed by the SIS Act. Conduct will also be shaped by obligations to regularly report and disclose; a consciousness that conduct is actively monitored and non-compliance will be detected, reported and acted on; and the forces of competition and community expectation.

Given APRA and ASIC have areas of common interest in their regulation and supervision of the superannuation industry, both regulators have established communication and coordination processes to minimise duplication of activity to the extent possible. To provide further clarity on these processes, and the roles of the respective regulators, APRA and ASIC have prepared an information paper which will be published imminently on the websites of both regulators.

APRA's role

Under the SIS Act, APRA is tasked with administering specific legislative provisions designed to protect the interests of superannuation fund members. Section 6 of the SIS Act makes clear which provisions fall within APRA's regulatory remit and those which fall to other regulators in the superannuation system, namely the Australian Securities and Investments Commission (ASIC) and the Australian Taxation Office (ATO).

Under section 34C of the SIS Act, APRA has long had a role in regulating the practices (and hence actions) of RSE licensees with a view to ensuring their compliance with relevant prudential requirements set out in the SIS Act and its regulations. The power to make and enforce prudential standards that support the prudential soundness of the entities that APRA regulates is built on APRA's existing powers under the SIS Act, and enables APRA to

establish principles-based requirements that can be readily adapted as the industry evolves. The prudential standards have been essential to APRA's effectiveness as the prudential regulator in other APRA industries for many years, and more recently in the superannuation industry.

APRA's prudential regulation considers, in part, how the actions of responsible persons (and persons with delegated authority) can affect the safety and soundness of the RSE licensee's business operations – whether directly (by failing to comply with a specific prudential requirement) or indirectly (by failing to follow a policy or procedure put in place to support the prudent management of the business operations). A key objective of APRA's proposed enhancements to its prudential framework is to embed a consideration of the needs of members ('the member voice' referred to by the Commission) in the decision making of RSE licensees.¹¹

ASIC is principally responsible for the administration of the *Corporations Act 2001*, which regulates the conduct and disclosure obligations of financial services providers. As the conduct and disclosure regulator, ASIC's role in superannuation primarily concerns the relationship between RSE licensees and individual consumers. In particular, ASIC's focus is directed at ensuring RSE licensees meet their conduct obligations in their dealings with consumers, including disclosure and advice to members and ensuring members have access to complaints processes.

The Commission notes that APRA's Statement of Expectations is an important mechanism for clarifying the Government's expectation of APRA and it should be updated regularly to reflect what it considers to be APRA's regulatory responsibilities. APRA agrees that it is important that the Government and APRA have a contemporary shared understanding of how APRA's supervisory approach can optimise consumer and community outcomes whilst not jeopardising prudential safety.

Interaction between APRA and ASIC

APRA and ASIC effectively work together to ensure there is a strategic approach to regulating the superannuation industry to the benefit of members. While areas of common interest in the jurisdictions of APRA and ASIC can create the perception of regulatory overlap and duplication, in practice both agencies seek to effectively manage this risk through well-established communication and coordination practices.

At a formal level, ASIC and APRA have a Memorandum of Understanding (MOU) which sets out a framework for cooperation between the two agencies in areas of common interest where co-operation is essential for the effective and efficient performance of their respective financial regulation functions. APRA and ASIC have built on the MOU to have a strong working relationship to support the carrying out of their respective responsibilities for regulating superannuation entities, including coordinated actions in respect of individual RSE licensees, preparation and follow-up of thematic reviews, and the routine sharing of information and data to inform surveillance and monitoring activities. Communication mechanisms are in place to ensure, to the extent possible, that actions by each regulator do

¹¹ APRA Discussion Paper, *Strengthening superannuation member outcomes*, 13 December 2017.

not result in an inconsistent or duplicative regulatory burden for the RSE licensee in question or the industry as a whole.

There will inevitably be occasions when RSE licensee conduct may attract the attention of both APRA and ASIC, albeit from different regulatory perspectives. For example, while matters of poor conduct in the dealings of RSE licensees with individual consumers is the responsibility of ASIC, that conduct may also raise prudential concerns in relation to the operations or practices of RSE licensee that may ultimately impact the interests of members and raise prudential concerns and hence also fall within APRA's responsibility.

Improving the quality of superannuation data

Incomplete, inconsistent or otherwise inaccurate data limits the ability of APRA, industry and other interested stakeholders to understand and analyse how fund assets are being used to support the delivery of quality member outcomes. It is increasingly important that RSE licensees be able to assess, and provide to APRA, information about the outcomes being delivered to members and information that allows the RSE licensee to be satisfied that they are operating their businesses in the best interests of member.

Under the SIS Act and the *Financial Sector (Collection of Data) Act 2001*, APRA collects a range of data to support its supervisory activities. Using this data, APRA also produces regular publications that include information on the financial position and other aspects of all APRA-regulated industries, including the superannuation sector, which is often used by stakeholders for comparative analysis.

APRA's current superannuation reporting collection was developed and implemented as part of the Stronger Super reforms, and significantly increased the amount, depth and breadth of data that APRA required RSE licensees to report for prudential purposes. APRA also sought to enhance the data collected and published on the superannuation industry, to provide increased transparency and insights on its operations.

The enhanced data collection has now been in place for five years. The superannuation industry has made sound progress in providing the data required by APRA. The quality of reporting is improving as the industry embeds systems and processes for collecting and reporting the required data. APRA has also worked with industry to refine aspects of the reporting requirements and instructions over time, improving the quality and consistency of reporting. Whilst APRA acknowledges that the data quality being reported needs improving, it is worth noting the relative immaturity of the new reporting framework for superannuation, which has expanded from a few hundred data items to thousands of data items under the new framework.

While substantial progress has been made, further improvement is needed both in terms of the range of data that APRA collects and the quality of data that RSE licensees submit to APRA and otherwise make publicly available.

APRA has identified a number of areas to address, including providing further clarification of existing requirements that will assist in improving the quality of data collected. For example, APRA has undertaken analysis of the open text fields being reported under 'other expenses' to determine enhancements that APRA can make to the reporting standards to improve

transparency. APRA's current post-implementation review will also consider the effectiveness of the reporting standards and guidance material, and assess whether they have achieved their objectives and remain fit for purpose.

As outlined in APRA's December discussion paper, 'Strengthening superannuation member outcomes', APRA is also seeking to improve the quality of data reported to it on expenses. Areas for possible improvement include collecting data at the RSE licensee level, collecting look-through information to better understand the financial flows to associated third parties, clarifying definitions and ensuring consistent treatment of expenses across RSE licensee business operations. Whilst APRA continues to work with individual entities to improve the quality and reliability of the regular data reported, this has not yet resulted in a complete and consistently reported data set relating to expenses (as currently required to be reported). This also will not address all of the current limitations in reported data (e.g. the lack of look-through for expense reporting).

APRA supports the Commission's view that there are benefits in making simple dashboards available to members – relating to both MySuper and choice products – and APRA's reporting standards can support such dashboards by providing a consistent and comparable methodology for metrics on dashboards. APRA notes, however, that dashboards are only one layer of information that is necessary to assist members making decisions.

The collection of additional or amended data does come with attendant costs – both in the transition to the new reporting obligations and in ongoing provision of data to regulators or on fund websites. In particular, during the consultation on the revised reporting framework in 2012/13 concerns were raised in relation to the challenges and costs of reporting more granular information on investment assets allocation and performance, particularly for all (or a significant proportion of) choice investment products and options. APRA encourages the superannuation sector to continue to work together to support greater transparency of fund operations and outcomes being delivered in a manner which ensures the efficient provision of the necessary data.

APRA shares the Commission's disappointment at the industry's reticence to provide the data requested by the Commission. This is data which, in APRA's view, should be available as it is essential if an RSE licensee is to have the necessary understanding of the outcomes being provided to fund members. APRA therefore encourages all RSE licensees to respond to the Commission's information requests in a full and timely manner.

APRA has, since 2011, committed to the Australian Government initiative to use Standard Business Reporting (SBR) reporting taxonomies to ensure consistency of data definitions. APRA has recently commenced a major data transformation program to keep pace with advancements in data, analytics and technology. Replacing the current data collection tool – Direct to APRA (D2A) – is critical to this program as it can be the process of translating information held for the RSE licensee's own internal purposes into a format for ready submission to APRA that can result in cost and complexity. APRA has been progressively adopting SBR since 2011 and intends to develop the new system fully based on SBR.

APRA welcomes the Commission's suggestion that APRA, with the other superannuation regulators, work closely to ensure policy oversight of data issues and work towards improving the quality of data available on superannuation.



 **APRA**