Draft SPG 516 – Business Performance Review

FSC Submission

October 2019

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1. About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in Australia's largest industry sector, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

2. Introduction

Overall, the FSC and our members appreciate that the Draft SPG 516 avoids excessive prescription and instead provides flexibility for trustees in how they undertake the Business Performance Review (BPR) process.

We note APRA's encouragement to take a "continual improvement" approach to this process, and as such we expect that additional guidance may be required as the Member Outcomes regime matures to ensure consistency in approach where this is useful or beneficial. We look forward to continuing to work with APRA to improve the BPR process.

While we are generally pleased with the direction taken, the FSC has some comments relating to the practical application of certain aspects of SPG 516. Section 3 of this submission includes detailed feedback on the key areas of concern for FSC members.

We note that it is likely further updates will be required to SPG 516 once Regulations relating to the legislated Outcomes Assessment are finalised.

In a general sense, it would also be helpful for APRA to clearly articulate how it envisages the BPR and Outcomes Assessment working in conjunction with other policy initiatives, including APRA's forthcoming heatmapping of superannuation products, the Design and Distribution Obligations regime, and work developed as part of the Retirement Incomes Framework. There are clear risks that arise from the development and publication of assessments of performance and outcomes that use different metrics and methodologies.

3. Detailed feedback

3.1. Timing

We note that the updated SPS 515 does not require trustees to consider the legislated outcomes assessment in the first BPR to be performed by 31 December 2020.

The FSC welcomes APRA's clarifications in relation to the timing required for undertaking the legislated Outcomes Assessments. We also agree that, while the legislated Outcomes Assessment is not mandatory for the first year, it makes sense for funds to use this opportunity to develop and test their frameworks without the requirement to publish results.

3.2. Data

Availability of data

Paragraph 64 of the draft SPG 516 encourages funds to link outcomes assessments to the publication of APRA's annual data.

While this makes sense, the lag in publishing this data creates difficulties for funds completing assessments in a timely manner and linking the timing of assessments appropriately to the BPR process. The expectation that assessments could be completed within two months of publication (particularly when this coincides with the holiday period) may also be unrealistic. Even if assessments can be completed in this time period, the data upon which they are based is likely to be up to eight months old by the time reporting occurs.

More timely publication of data would significantly improve this process for funds.

Timely release of data should also be considered in relation to APRA's other data-related projects, such as the proposed heatmapping of superannuation products, to allow this information to be fed into assessments as appropriate.

Recommendation: APRA should work toward earlier public release of superannuation data for use in business planning and outcomes assessments, and provide an indicative timetable of intended release dates.

Consistency of data

Some inconsistencies have also been observed in how RSE Licensees have interpreted the input to the reports that are prescribed for use for MySuper assessments. This will have result in inaccurate comparisons between funds.

For example, simple analysis of the FY18 MySuper statistics shows variation between fees as reported and those disclosed by funds.

Recommendation: APRA should work to ensure that data which will be used in business planning and outcomes assessments is accurate and consistent.

3.3. Benchmarking

Investment benchmarking

Paragraphs 30-31 discuss the use of reference portfolios to benchmark investment performance and value added over time. It is worth noting that most funds will already have in place a range of relevant benchmarks and indices to track performance, which may also be suitable for use in the BPR process.

While we agree that benchmarking investment performance against reference portfolios is a useful way to compare performance against the market, for the purpose of assessing member outcomes it often makes sense to compare investment performance against an investment option's return objective, rather than a separate reference portfolio.

This is because:

- The trustee should be focusing on investment option performance against the return objective (and the investment objectives of members); and,
- Many diversified investments seek to perform against an absolute return relative to CPI.

Recommendation: Specify that funds may use existing indices and benchmarks to evaluate portfolios, and may not need to construct reference portfolios specifically for this purpose.

Insurance benchmarking

The Draft SPG 516 suggests that product design and premium levels may be appropriate metrics for assessing insurance products, as well as claims related metrics.

As noted in paragraph 36, it can be challenging to compare insurance provided within superannuation products, particularly for corporate plans where the insurance design is not only bespoke to particular employers but also particular employment categories. Some employers also subsidise fees and/or premiums, which may significantly alter the value proposition for members.

Other metrics, such as premiums relative to account balances over a period of time, may be more appropriate in some instances.

It should also be acknowledged that, while cost of cover is an important consideration, a focus on absolute premiums may not be an appropriate metric for assessing insurance. Providing insurance with more benefits, and fewer onerous exclusions for pre-existing conditions, will cost more but also provide a greater benefit to members.

It will be important that, where insurance provides good outcomes for members, variations in insurance offerings are not seen to disadvantage funds as they undertake benchmarking, as this risks a 'race to the bottom' by insurers and funds and could impact long-term sustainability.

The FSC also acknowledges that an industry-led approach to consistent data collection may be a sensible approach, given the small number of insurers in the market relative to the number of funds collecting data.

Recommendation: Clarify that other metrics may be used in relation to assessment and benchmarking of insurance products, where they provide a more useful measure of member outcomes, an standardise insurance data where possible.

Retirement offering benchmarking

Paragraph 38 suggests that funds should consider the adequacy and stability of retirement income for their members in retirement phase.

However, in most circumstances the fund will not have a holistic view of a member's entire financial situation at retirement – for example, other assets they hold outside of super, other super accounts, their eligibility to receive social security benefits or their lifestyle expectations.

Many members will seek access to personal advice relating to complex issues such as an appropriate drawdown amount, which may be dictated by their social security benefits, estate planning considerations, or any transition-to-retirement strategy they are managing outside their superannuation.

Understanding adequacy requires an understanding of all of these complex inter-related factors, and member-provided information may not always be accurate or complete. This means that, while funds will undertake benchmarking on a best-efforts basis, there may be ongoing data gaps that will need to be considered.

We do expect that maturity of data collection and benchmarking should mature in this area over time. Funds are increasingly seeking more information from members purchasing retirement products to ensure suitability, but with the Government's Retirement Incomes Framework yet to be implemented, there is not yet a consistent approach to risk and disclosure for retirement products. More clarity around the expected approach to considering adequacy would be helpful for funds.

Recommendation: Clarify expectations regarding benchmarking of adequacy for retirement income products, and specify any intention to review and refine requirements in future.

Defined benefit and legacy products

Additional clarity is requested in relation to paragraph 43, which indicates a Board-approved transition plan could be relied upon in assessing performance of legacy products. We understand this to mean that, while legacy products should be included in the BPR process, having a transition plan in place satisfies any obligations in relation to assessing results or identifying improvements.

Recommendation: Explicitly state the BPR expectations in relation to legacy products where a transition plan is in place.

3.4. Outcomes Assessments

Ranking of MySuper performance

The FSC is pleased that the Draft SPG 516 acknowledges the limitations involved in benchmarking lifecycle products at the aggregated product level. However, it is important to note that these issues are likely to persist even at the age and option level.

This is because lifecycle products are constructed differently across providers and there is not a single homogenous model – most have differences in age bands, investment options, asset allocations and glide paths. Some of the investment fees and ICRs may also vary across lifecycle options due to different investment strategies and levels of investment risk, which affects net returns.

In some instances, it may even be most appropriate for funds to go beyond MySuper products to make like-for-like comparisons. For example, a conservative/older cohort might be better compared with a cohort of conservative choice products rather than just a few conservative lifecycle stages.

It is worth noting that retrospectivity may also be a challenge for MySuper products which were constructed within the last five years, and were not effectively the same product as previous default options.

Recommendation: Note within guidance the challenges of comparing lifecycle products with different features and strategies.

Choice products

Noting that the regulations relating to the legislated Outcomes Assessment have not been finalised, and that it will likely be necessary to further update SPG 516 to reflect these, there are several issues that should be considered in relation to the development and delivery of outcomes assessments for choice products.

For example:

- Different products, even within categories of choice product, may be constructed differently and be difficult to compare, as they will have differing risk profiles and asset allocations and there is currently no consistent, objective approach to risk adjustment.
- For investment options that directly track an index, there is little to differentiate options other than fees, which are compared elsewhere in the assessment.
- Some metrics will be less meaningful for some choice products, which will require tailored assessment frameworks.

It is also not clear how performance of products with a significant number of investment options should be measured in comparison to peers, as this would require funds to analyse (and find a way to compare) performance of each investment on their competitors' menus. This would still not take into account differences in target markets and risk levels for these products.

It should also be noted that Boards, via their investment committees, should already have in place robust investment governance frameworks which involve objective benchmarking and comparisons to monitor performance, tailored to particular funds and products.

Investment strategy

It is not clear, based on the discussion of investment strategies in this section of the Draft SPG 516, the extent to which external managed funds and products, such as individual investment options in a platform or wrap environment, are expected to be included in the legislated Outcomes Assessment.

For example, the trustee is responsible for delivering against the investment strategy of each of the fund's investment options. However, where a member (likely with the assistance of their financial adviser) controls the investment of their own funds through a wrap-style product, the trustee should not be held responsible for the investment returns experienced by that member based on their own investment strategy and choices.

Platform operators do, however, already have robust investment governance frameworks which include review processes for investment options they make available. These existing quality control processes are one component of an Outcomes Assessment, along with the assessment of the structure of the product, fees and costs, liquidity rules, diversification and so on.

An overall assessment of the quality of an investment menu may be more appropriate than measuring performance of individual investment options.

Given poor outcomes may result from inappropriate allocation to investments that may form an important part of diversified portfolios (such as cash options), no amount of assessment or review of options provided will shelter all users of choice products from poor performance. In most cases, the trustee will also not understand the investment objectives of the individual, nor their broader financial situation, to know whether the performance of their investments is appropriate.

Restricting investments through this type of product, particularly where an individual is working with a financial adviser who is required to act in the individual's best interest, undermines the concept of providing investment choice.

For external managed funds, it is also impractical and adds little value for a fund to publish information relating to any assessments undertaken.

Recommendation: Clarify the extent to which external managed funds offered under a platform are required to be assessed as part of the Outcomes Assessment process, to ensure that performance of products where investments are not controlled by the trustee are considered only in an appropriate context.

Operating costs

It appears that paragraph 98 intends to capture the level of profit a fund returns to a parent company, and report this as part of the fund's operating costs.

While, in principle, we do not object to providing this information, there are several issues associated with this approach.

For large entities, this information may not be available at an individual super fund level due to the way businesses are structured. We are also concerned that this approach of considering returns as part of operating cost does not align with international accounting standards as it would result in double-counting of these numbers.

Recommendation: APRA should:

- ensure that any attempts to capture returns paid from a trustee to a parent company or related entity align with existing reporting standards;
- clarify expectations in relation to when publication of information about returns paid to parent companies is required;
- ensure reporting requirements take into account the impact on fund members rather than focusing on corporate structures.

Publication of Outcomes Assessments

The Draft SPG 516 suggests at paragraph 108 that determinations and product summaries be published no more than two clicks from the homepage of the trustee's website.

The FSC supports publication of this information but suggests that guidance should be focused on ensuring information is accessible at a location that makes sense for members. It should be sufficient that trustees ensure determinations and summaries are readily available and can be easily and quickly located by members.

We understand the concern that product summaries and determinations may be buried within a trustee's website and not able to be found by members. However, funds which offer multiple products will find it difficult to practically satisfy this guidance, and it increases the risk that all information will be published on one page, rather than in a relevant area of the website.

In addition, websites designed for mobile devices generally require more segregation of the menu to allow for the smaller screen size, which would make it harder to satisfy this guidance.

We are also highly supportive of members being notified regarding publication of determinations and product summaries and believe other potential methods of communication should be included in APRA's guidance. Other potential methods of communication include notifications on fund websites and online service portals, and links within member statements.

It will also be important to ensure disclosures are provided in a manner that is meaningful and useful to the intended audience. In particular, there is potential for information contained in these documents to create a focus on past poor performance rather than being able to articulate the forward-looking changes and improvements made in response to any issues identified as a result of undertaking the outcomes assessment.

It would be helpful for the SPG to specify that funds may communicate in the manner that is most appropriate for their members.

Recommendation: Amend the SPG such that it provides funds more flexibility in how they notify their members and where they position their determinations/summaries.