RESPONSES TO QUESTIONS TAKEN ON NOTICE: House of Representatives Standing Committee on Economics hearing on 28/11/2014

Australian Prudential Regulation Authority

Question One: Mr Husic (transcript page 10)

Mr HUSIC: […] I understand earlier this year—in about January—APRA had a report that covered in part annual superannuation statistics that dealt with, for instance, the amounts that trustees drew. Am I right to understand that retail sector trustees directors drew close to $450 million in 2013 and that director fees for industry super funds were about $88 million? Would my understanding of that be correct?
Mrs Rowell: I would have to check the figures.
Mr CONROY: That is table 8 of your annual statistics on superannuation. It is page 27.
Mrs Rowell: I do not have that with me.
Mr HUSIC: You do not carry every single report of APRA?
Mrs Rowell: If that is in the tables then the numbers are correct, but I think the question is what the numbers represent and that might be the question you want answered and I cannot do that off the top of my head, I am sorry. I can take it on notice.

Answer:

Table 8 of APRA's 2013 *Annual Superannuation Bulletin* provides aggregate information sourced from information reported at the RSE level for superannuation entities with more than four members under reporting form SRF 200.0 *Statement of Financial Performance.* The table shows 'Directors/trustees fees and expenses' for Corporate funds of $5 million, public sector funds of $6 million, industry funds of $88 million and retail funds of $449 million.

Item 18.4 *Directors/Trustee fees/expenses* is defined to include "fees paid/payable by the superannuation entity to the Directors/Trustee(s) for services in carrying out the functions of a Trustee/director, including any consulting or administration services provided." It does not include "amounts paid to Directors/Trustee(s) that represent a direct reimbursement of expenses incurred by the Directors/Trustee(s) on behalf of the superannuation entity … expense for Trustee indemnity insurance [or] … commissions collected by the trustee for payment to a third party."

The data reported on SRF 200.0 *Statement of Financial Performance* is not necessarily comparable across different entities or types of entities. For some entities, for example, it may include amounts other than directors' fees (for other services provided by the directors to the RSE). For other entities it may not represent all of the amounts paid to directors, for example, because some payments to directors may be made by the RSE licensee and would not be captured in the RSE level data submitted to APRA.

As part of Stronger Super reforms, APRA introduced enhanced reporting requirements which commenced progressively from 1 July 2013. As a result, APRA now also collects separate information on directors' and trustees' remuneration at the RSE licensee level. Specifically, RSE licensees must report all directors and the remuneration paid to a director, individual trustee or alternate director of the RSE licensee with respect to their role for the RSE licensee at item 2 'Details of directors, individual trustees and alternate directors' on reporting standard SRF 600.0 *Profile and Structure (RSE Licensee).* 'Remuneration' for this purpose "has the meaning given, in the context of an officer (including an RSE licensee director), in the Part 9 Dictionary of the Corporations Act 2001" and

accounting standards. That is, remuneration should include direct and indirect payments to directors for their management of the RSE, from the RSE licensee or any related party.

APRA will consult on the confidentiality and publication of the new quarterly annual data submitted by RSE licensees – including the information provided on SRF 600 – in 2015.

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Question Two: Mr Husic (transcript page 10)

Mr HUSIC: Can you also take on notice a breakdown of those director fees relative to member numbers within retail funds as opposed to industry super funds? My calculations show that director fees for each retail fund member were about $32 a year compared to a shade under $8 for industry super fund members. If you could confirm whether my understanding is correct, I would be most grateful, thank you.

Answer:

The Australian Prudential Regulation Authority (APRA) does not collect or publish Directors/trustees fees and expenses per member account. As noted in the response to Question 1, the information published in Table 8 of APRA's 2013 *Annual Superannuation Bulletin* for 'Directors/trustees fees and expenses' is not comparable across different entities or types of entities. Hence, in APRA's view it is not appropriate to convert this information to a per member figure for comparison purposes as it would not provide meaningful information.

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Questions Three and Four: Mr Conroy (transcript pages 14-15)

Mr CONROY: I would like to pick up on the chair's line of inquiry around directors fees. In particular, I have given you a copy of your 2014 statistics, which refer to the 2013 year. I would like to go to table 8, on page 27 of that particular report, which I have dog-eared for you. Can you confirm that directors' fees in retail superannuation funds are $449 million a year?
Mrs Rowell: That is the number that is in the table
Mr CONROY: Can you confirm that for industry super funds it is $88 million a year?
Mrs Rowell: Yes.
Mr CONROY: You might need to take this on notice to confirm it. By dividing those fees by the number of accounts in each category that is also present in your report, I get $31 for average directors' fees for a retail super member versus $7.65 for an industry super fund member. Would you mind confirming that on notice?
Mrs Rowell: Yes.

Answer:

Refer to the response to Question One.

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Question Five: Mr Conroy (transcript page 15)

Mr CONROY: […] Could you also take on notice to confirm that on my reading of fund-level rates of return—rather than averages—there is only one retail superannuation fund in the top 47 performing superannuation funds in this country? That is according to your 2013 superannuation rates of return figures, released on 8 January this year
Mrs Rowell: Yes.

Answer:

The Australian Prudential Regulation Authority's (APRA's) June 2013 edition of the *Superannuation Fund-level Rates of Return* publication contains whole-of-fund rates of return for the largest 200 superannuation funds and eligible rollover funds.

Table 1 of the Excel publication ranks superannuation funds on: one-year rates of return (June 2013); five-year per annum rates of return (2009-2013); and ten-year per annum rates of return (2004-2013).

One-year rate of return (June 2013): fifteen superannuation funds classified as retail fund types are ranked in the top 47 superannuation funds, based on a ranking of one-year rates of return (June 2013).

Five-year rate of return (2009-2013): six superannuation funds classified as retail fund types are ranked in the top 47 superannuation funds, based on a ranking of five-year rates of return (2009-2013).

Ten-year rate of return (2009-2013): one superannuation fund classified as a retail fund type is ranked in the top 47 superannuation funds, based on a ranking of ten-year rates of return (2004-2013).

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Question Six: Mr Conroy (transcript page 16)

Mr CONROY: […]I would also like to go to page 15 of the report (working paper produced by APRA *Australian superannuation outsourcing – fees, related parties and concentrated markets* 12 July 2010), which finds that the median retail fund charges $10 million more for services from related providers than the median not-for-profit fund. Would you mind taking on notice – and maybe talking to the authors of the working paper, if they are still in APRA - your point, Mr Byres – that is, are they like for like comparisons? I presume that given the excellent work of your agency you would not put tables out that are not fair comparisons.
Mrs Rowell: . Can I just say there, though, that the data we have is limited, so it depends on the granularity of the data we have as to whether we are able to actually confirm whether the services are like for like.
Answer:

The working paper *Australian superannuation outsourcing – fees, related parties and concentrated markets* (12 July 2010) was authored by two Australian Prudential Regulation Authority (APRA) researchers and is based on a survey conducted in 2006. The views in the paper reflect the authors' views and not the view of APRA.

Table 6 on page 15 of the working paper compares **estimated** administrative services costs across types of funds based on models developed by the researchers using the data submitted by the entities surveyed. The amounts quoted do not represent actual administration costs for specific funds. Further, the models compare fees based on fund size and do not reflect other attributes such as the specific nature of the services provided. Hence it is difficult to conclude the degree to which they provide like for like comparisons.

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Question Seven: Mr Conroy (transcript page 16)

Mr CONROY: Also, could you take on notice the question of whether the working paper, or the calculations underpinning it, come to an aggregate figure for the related service providers? How much, as an aggregate figure for all retail fund members, was paid to retail service providers, both the global figure and for the $300 excess? By my calculations, if you multiply the $300 extra they are paying for related service providers by the number of accounts, you get $4.3 billion of additional fees. To my line of thinking the $4.3 billion that retail super funds have been, some would argue, gouging off their members is more significant when compared with $100,000 one entity may have raised through dubious activities. I will ask you to take on notice whether you are able to derive a figure for that particular area.

Answer:

As noted in the response to Question 6, the working paper *Australian superannuation outsourcing – fees, related parties and concentrated markets* (12 July 2010) was authored by two Australian Prudential Regulation's (APRA) researchers and is based on a survey conducted in 2006. The views in the paper reflect the authors' views and not the view of APRA.

The working paper does not include an aggregate figure for related service providers. Further, as noted the figures quoted in the paper are estimates based on models developed by the researchers using the data submitted by the entities surveyed and so cannot be aggregated to provide a total figure for related party service providers.

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Question Eight: Mr Conroy (transcript page 16-17)

Mr CONROY: You would look specifically at this process to satisfy yourself that they engage in a genuine process to satisfy themselves that this was value for money for their members
Mrs Rowell: We do.
Mr CONROY: Perhaps on notice, can you provide evidence to this committee about the number of times you have found that funds have not done that? I am not asking for specifics because I do not want to breach confidentiality. Could you provide, as a percentage of your interactions with funds in this area, how many have been found to be substandard in this area?
Mrs Rowell: I will need to take on notice what we might be able to provide in that sense. You have to appreciate that to some degree there are judgements to be made and trade-offs to be made in making any decision about a service provider, and you have to weigh up the costs and the like with other benefits that might be involved in the overall relationship.

Answer:

APRA's expectations in relation to use of service providers are set out in Prudential Standard SPS 231 Outsourcing and Prudential Practice Guide SPG 231 Outsourcing. In addition, Prudential Standard SPS 521 Conflicts of Interest and Prudential Practice Guide SPG 521 Conflicts of Interest apply to related party arrangements. Specific requirements in relation to, for example, the selection of an insurer are contained in Prudential Standard SPS 250 Insurance in Superannuation. This standard requires that a Registrable Superannuation Entity (RSE) must develop and implement a selection process for choosing an insurer that includes, at a minimum, consideration of the prospective insurer's terms of cover and exclusions, claims philosophy, the reasonableness of the premiums to be charged. The RSE must undertake a due diligence review of the selected insurer; and be able to demonstrate to APRA the appropriateness of the selection process and due diligence review and how it is applied. Importantly the Standard requires that an RSE licensee must be able to satisfy itself, and demonstrate to APRA, that the engagement of an insurer is conducted at arms'-length and is in the best interests of beneficiaries. The Prudential Standards and Prudential Practice Guide were introduced in July 2013.

APRA views the effective implementation of the new superannuation prudential standards as a high priority, particularly in the areas of conflicts of interest. APRA recently completed a thematic review on implementation of SPS 521 and is currently undertaking a thematic review on implementation of SPS 250, based on a representative sample of funds. APRA expects to release information on the outcomes of these thematic reviews in early and mid-2015 respectively.

These thematic reviews identified that there is room for improvement in management of related party arrangements, and insurance arrangements more generally. For example, in regard to insurance, there is evidence that some trustees unduly rely on the insurer for monitoring and reporting processes, and for input and advice when considering claims decisions. There were some cases where the engagement process for related parties could be improved, including the identification and management of conflicts for directors and other responsible persons in relation to decision making. There were also some cases where product features, or other terms and conditions for services offered by related parties were not necessarily competitive or established on

arm's length terms. In these cases, APRA has advised the relevant funds that it expects all RSE Licensees to benchmark the terms and conditions for the relevant arrangements and/or for negotiations to take place between RSE Licensees and related party service providers to ensure that competitive and arm's length terms are provided for superannuation fund members. APRA will continue to review related party arrangements, and ensure corrective action is taken where necessary, as part of its ongoing supervision activities.

There were requirements in place prior to 1 July 2013 in relation to management of service providers, however these were not articulated as explicitly as under the new prudential standards. APRA is not readily able to provide information on the percentage of funds that were found to not meet APRA's expectations based on past supervision activity related to our review of the selection process for the appointment of service providers. This review work would generally have been undertaken as part of APRA's regular supervision activities. Any recommendations or requirements in this area would be documented as part of the reports issued following these activities and it would be very labour intensive to separately collate this information.

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Question Nine: Mr Conroy (transcript page 17)

Mr CONROY: You might take this on notice: how many staff are allocated to looking at these sorts of issues and making sure that when superannuation funds change their investment behaviour or their systems that they go through these proper processes – and I acknowledge that it might be a part of people's broader jobs?
Mrs Rowell: It would be, at best, a ballpark estimate.
Mr CONROY: In the ballpark, how many people are allocated to this compliance activity? Related to this – and we talked about conflict of interest for directors previously through the Chair's evidence – are you aware of conflicts of interest where directors of superannuation funds are receiving fees or incentives based on the use of related parties?
Mrs Rowell: I do not think I can answer that question off the top of my head.
Mr CONROY: Could you take that on notice?

Answer:

The Australian Prudential Regulation Authority (APRA) has approximately 280 staff directly involved in supervision activities, supported by approximately 140 technical experts across its regulated industries. Around 26 per cent of these staff (109) are devoted to the superannuation sector.

As noted in the response to Q8, APRA reviews adherence to the prudential standards as part of its ongoing, business as usual, supervision activities. Prudential Standard SPS 510 Governance (SPS 510) and Prudential Practice Guide SPG 511 Remuneration were introduced for the superannuation industry from 1 July 2013. Under SPS 510 a Registrable Superannuation Entity (RSE) licensee must establish and maintain a documented Remuneration Policy. The Remuneration Policy must outline the remuneration objectives and the structure of the remuneration arrangements, including, but not limited to, the performance-based remuneration components of the RSE licensee. Any performance-based components of remuneration must be designed to encourage behaviour that supports protecting the interests of beneficiaries.

The new 'Conflict of Interest' requirements under Prudential Standard SPS 521 and Prudential Practice Guide SPG 521 cover the issue of related party arrangements. As also noted in response to Q8, APRA recently conducted a thematic review into 'Conflicts of Interest' and the outcomes of this review will be published in early 2015. These reviews did not include directors' remuneration arrangements as a specific area of focus, however these arrangements were considered in some of the reviews as one of a number of examples of possible areas where conflicts of interest may arise (along with, for example fees and insurance arrangements). APRA did not identify from this thematic review any specific cases where directors are receiving fees or incentives based on the use of related parties.

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Question Ten: Mr Kelly (transcript page 22)

Mr KELLY: The question is obvious. In such a restrictive covenant, in a contract that forces an employee to invest only their superannuation money in one particular fund, has APRA given any thought to whether that is in breach of any of our current laws
Mr Byres: As I said, if it is being done as part of an industrial agreement, which has been appropriately constructed, then that ends our consideration of the issue.
Mr KELLY: Is that something to perhaps take on notice? Is that something you have given any consideration to? Are there any examples of you having given consideration to whether that type of agreement is against any Australian law? Have you have looked at it and said yes or no? Please take it on notice, if you have not looked at that particular issue..
Mr Byres: Without trying to frame your question, the easiest question for us to answer is on whether there are instances where we have identified that potential issue.
Mr KELLY: Yes, and then whether you have looked at it and made a decision on whether it is or is not in breach of any existing Australian law.

Answer:

The *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004* imposed obligations upon employers to make superannuation contributions on behalf of their employees to complying superannuation funds in compliance with the new 'choice of fund' requirements. Sections 32C and 32D of the *Superannuation Guarantee (Administration) Act 1992*, expressly excluded employers with certain existing arrangements from 'the choice of fund' obligations. These arrangements include circumstances in which an employer makes contributions:

- to the Commonwealth Superannuation Scheme, Public Sector Superannuation Scheme and contributions made under the *Superannuation (Productivity Benefit) Act 1988*;
- under or in accordance with an Australian Workplace Agreement or certified agreement under the *Industrial Relations Act 1988* or made under certain Victorian agreements;
- in respect of an employee where the contribution is made under or in accordance with a State industrial award.

Where these types of industrial agreements are in place, there is a legal basis for not extending the 'choice of fund' requirements to the employees captured by these agreements.

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Question Eleven: Mr Husic (transcript page 24)

Mr HUSIC: Having sought to be a bit more virtuous at the start of my questions, I now return to the issue that everyone has been talking about: the conflicts-of-interest issue. Has APRA observed whether conflicts are more prevalent due to profit orientation? For example, the authors of the 2010 report said on page 2 of that report:

We find that 'relatedness' per se is not detrimental to fund members. However, when we consider whether the fund has been established on a not-for-profit basis, or as a retail commercial endeavour, we find that the trustees of retail funds pay significantly higher fees to related service providers. In contrast the fees paid by trustees of not-for-profit funds to related parties are not significantly different than those to independent service providers.

I guess the question is: doesn't the evidence suggest that the greater risks around governance and related party transactions are due to pursuit of profit rather than governance structure? Could you take that on notice?

Mrs Rowell: I will make an initial response – and we will come back with a response on notice - and just note that our thematic review on conflicts of interest covered both not-for-profit and for-profit funds. We found there was room for improvement across the board. Weaknesses in dealing with conflicts of interest are not particular to one particular segment of the industry.

Answer:

As noted in the responses to previous questions, Prudential Standard SPS 521 Conflicts of Interest (SPS 521) and Practice Guide SPG 521 Conflicts of Interest set out requirements and expectations for Registrable Superannuation Entity (RSE) licensees in relation to managing conflicts of interest within their fund operations. These obligations apply across the superannuation industry, irrespective of whether RSE licensees operate on a for-profit or not-for-profit basis.

APRA recently conducted a thematic review of the implementation of SPS 521 and the outcomes of the review will be published in early 2015. A total of 37 entities were included in the thematic review. Around one third were assessed as less than adequate based on the review of their policy and practices against the requirements set out in SPS 521, both overall and for each industry segment. Further, APRA observed a lack of consistency across the industry in relation to RSE licensees identifying and managing conflicts of interest when dealing with intra-group service providers and related parties. This is an area in which APRA will expect to see improvements over time.

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Question Twelve: Dr Hendy (transcript page 25)

Dr HENDY: What other government agencies have you talked to that might be involved in investigating what Cbus has been doing ?
Mrs Rowell: We have had discussions with ASIC about some of the issues that have emerged—just to share information. I cannot off the top of my head—
Mr Byres: We can take that on notice.
Dr HENDY: Could you take that on notice and let us know.

Answer:

The secrecy provisions contained in the *Australian Prudential Regulation Act 1988* prevent the Australian Prudential Regulation Authority (APRA) and its officers from disclosing information relating to the supervision of a particular entity. Accordingly, APRA cannot provide information on specific entity matters beyond information that may already be in the public domain.

APRA continues to have regular engagement with Cbus in relation to the matters being considered by the Royal Commission and the Privacy Commissioner, and has had discussions with Counsel assisting the Royal Commission. Consistent with APRA's expectations, Cbus has been responsive and open in its communications with APRA.

The Cbus Board has established an Independent Governance Review (Review) which is being conducted by Professor Graeme Samuel AC, former Chair of the Australian Consumer and Competition Commission, and Mr Robert Van Woerkom, Director of Pensions International. Cbus is also continuing to review its control framework and processes, and has engaged KPMG to provide forensic investigation services in relation to the matters arising from evidence before the Royal Commission.

APRA is considering the outcomes from the Royal Commission as they emerge and will review and consider the prudential implications of relevant Royal Commission findings when they are released. APRA will also consider the outcomes of the reviews commissioned by Cbus, to determine what additional steps may be appropriate as part of APRA's ongoing supervision of the entity. APRA will continue to liaise as appropriate with other government agencies on matters of common interest.