Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Additional Estimates

2016 - 2017

Division/Agency: Australian Prudential Regulation Authority
Question No: 153
Topic: Underperforming super funds
Reference: Written
Senator: Ketter, Chris

Question:

Ms Rowell: 'We publish the statistics. Our focus is actually on underperformance across the industry, and I think, when we have done some analysis recently, we are looking at the bottom performers very closely and are going to be having pretty firm discussions with them across a range of factors, not just net investment performance. Performance is a much broader set of metrics. Actually, in our list of the bottom segment, a large proportion of those are not-for-profit and industry funds in particular".
How many super funds are on APRA's list of underperforming funds? Of these, how many of these are:
- Not-for-profit
- For profit
- Industry
- Retail
- Bank-owned?

Answer:

The following is in response to Questions on Notice:
- 153 (SQ17-000207)
- 154 (SQ17-000208)

The Australian Prudential Regulation Authority's (APRA's) view is that, consistent with the underlying philosophy of the *Superannuation Industry (Supervision) 1993* (SIS Act), all RSE licensees should regularly assess the extent to which appropriate net outcomes for members are being achieved over the long term based on a broader set of qualitative and quantitative factors, regardless of whether or not they offer a MySuper product. This obligation exists, irrespective of the business model of the RSE licensee.

Business models vary significantly across the range of funds operating in the APRA-regulated superannuation industry. All RSE licensees, however, must be able to run their businesses so they can meet their obligations to fund members, as well as pay their staff and fulfil their contractual obligations with service providers – and hence set fees and charges to cover costs accordingly. Most relevant to assessing performance is the end outcomes for members in providing for their retirement, which is the result of the money being contributed, the investment return that is earned and the costs that are paid – irrespective of the business model of the fund charged with delivering those outcomes.

Consistent with this, fund performance must be considered over the medium to long term, and in a multifaceted way that goes beyond just looking at net investment returns – as important as that is to member outcomes. Accordingly, APRA has been encouraging RSES licensees to undertake a broad ‘member outcomes’ assessment, including consideration of net investment returns, expenses and costs, insurance, and other benefits and services provided, at the very least. When APRA comments on underperformance by superannuation funds, it is based on consideration of outcomes for members in all of these areas. It also takes into account APRA’s assessment of more qualitative aspects such as governance and risk management practices, and the approach taken to strategic and business planning. Also, as members join individual funds or products, APRA focuses on assessing performance at that level, as it is more meaningful in considering outcomes for members than the average performance of funds in different industry segments (however defined).

APRA is increasingly focusing its engagement with boards on their approach to ‘member outcomes’ assessment, and the actions taken in relation to identified areas of underperformance, in relation to both MySuper products and the funds under their oversight more broadly.

APRA now has an improved range of data about the superannuation industry that is providing a more comparable, reliable and consistent basis to assess how funds are tracking than APRA has had in the past. This data is demonstrating that, at a fund or product level across all segments of the industry, there are better performers, as well as underperformers with room for significant improvement. MySuper products have only been operational for a few years, and APRA has been observing industry practices over that period, identifying the better practices that are being adopted and providing guidance to industry as needed.

APRA’s assessment of available data has identified a population of around twenty to twenty five poorer performing funds/products on which we will be particularly focusing in our engagement with the relevant RSE licensees over the next 6 – 12 months. These include a mix of different business models/types (not-for-profit/for-profit; public offer/non-public offer; funds/products in each industry segment). It is also important to note that this set of funds/products have underperformed across a most or all of the different metrics considered by APRA; there are also many funds/products that have underperformed in a smaller subset of the metrics, and this underperformance will also be raised with the relevant RSE licensees during APRA’s supervision activities.

APRA intends to use a wide range of measures to assess performance or outcomes to members, and the assessment will to some extent be case-specific and the factors relevant to consider is likely to evolve over time. However key aspects that APRA looks at include:

- Total administration and operating expenses as a percentage of available net assets;
- Investment returns over different periods, relative to benchmarks/objectives set as well as peers;
- Premiums collected per (life) member as a percentage of average account balance;
- Net members’ benefits flow as a percentage of available net assets (Net cash flow ratio);
- Net rollovers as a percentage of available net assets;
- Members’ benefits outflow ratio;
- Net outward rollover ratio; and
- Percentage change in member accounts.

Governance has long been, and will continue to be, a key focus for APRA in discussions with all APRA-regulated industries, and superannuation is no exception. Whilst there are some very good practices, APRA's experience is that there is room for improvement for many funds across all segments of the industry, with some board practices failing to live up to expected standards of good governance. A particular current area of focus is practices for board selection, appointment and renewal.

APRA first introduced its *Prudential Standard SPS 510 Governance* (SPS 510) in 2013. This was seven years after the equivalent standard (*Prudential Standard CPS 510 Governance* (CPS 510)) was introduced for the banking and insurance industries.

The provisions of SPS 510 are aligned, to the extent appropriate[1], with equivalent provisions applying to authorised deposit-taking institutions (ADIs) and insurers under CPS 510.

As a result of the introduction of SPS 510, RSE licensees have, since 2013, been required to have in place a formal policy on board renewal.

On 3 November 2016, APRA released a final amended version of SPS 510, reflecting changes to support better governance practices by RSE licensees. The changes include that each RSE licensee board establish and implement policies and processes relating to the nomination, appointment and removal of directors. These policies and processes are required to address, inter alia, the length of director terms, maximum number of terms, how the board will assess the suitability of nominated candidates (including the assessment of independence where relevant) and the factors that will be consider4ed in determining whether an existing director will be reappointed.

APRA also updated guidance *Prudential Practice Guide SPG 510 Governance* (SPG 510) in November 2016. APRA's prudential practice guides are non-binding guidance which set out what APRA considers to be prudent practice in relation to key risk areas. APRA's view, as reflected in SPG 510, is that appropriate board renewal supports effective governance of RSE licensees and their business operations. APRA has therefore updated SPG 510 to reflect both that boards are expected to consider director's tenure at the end of each term served, and that APRA expects that there would be limited circumstances in which maximum tenure limits exceeding 12 years would be appropriate.[2]

<u>Board renewal and tenure policies</u>

All boards of APRA-regulated entities must strike a balance between ensuring continuity of experience and appropriate review and renewal of skills and capabilities as the industry and individual funds evolve.

APRA's view is that long periods of tenure can affect a person's capacity to exercise independent judgement. In 2015, APRA analysed director tenure in the superannuation industry compared to other industries, finding that more than 20 per cent of RSE licensee directors had more than 10 years of tenure (over 25 per cent for industry and corporate funds) and a significant number of RSE licensees have directors with more than 20 years (and in some cases more than 30 years) of tenure. In contrast, in the broader corporate community,

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[1] Note that SPS 510 does not include the board composition requirements that are present in CPS 510; this is because Part 9 of the *Superannuation Industry (Supervision) Act 1993* sets composition requirements for RSE licensees.

[2] Refer to paragraph 24 of SPG 510 which reads "*APRA expects a Board renewal policy would document the maximum tenure period for each director, including the circumstances where the RSE licensee may deviate from the terms of its tenure policy. APRA's view is that long periods of tenure can affect a person's capacity to exercise independent judgement. APRA expects that the length of each director's tenure would be examined shortly before the end of each term served and that there would be limited circumstances in which maximum tenure limits exceeding 12 years would be appropriate*".

only 7 per cent of independent directors have tenure longer than 12 years and only 3 per cent have tenure longer than 15 years.

The new material in SPS 510 provides more detail on APRA's expectations around the pre-existing requirement that an RSE licensee have a board renewal policy. The decision to add more detail in SPS 510 compared to CPS 510 was to address areas of poor practices observed across RSE licensees by APRA's supervision teams when assessing the implementation of SPS 510 requirements. It also responds to requests from industry during APRA's public consultation on SPS 510 and SPG 510 and our supervision activities for additional, more detailed guidance on APRA's expectations regarding the detailed policies and procedures underlying an RSE licensee's governance framework.

APRA now requires RSE licensees to have in place a policy on director tenure which addresses maximum tenure periods. This proposal is consistent with existing provisions in SPG 510 which outline expectations regarding tenure and is principles-based. RSE licensees are not restricted under SPS 510 to any specific limit on tenure, other than that set out in the RSE licensee's own tenure policy.

Submissions received during consultation on the proposed amendments to SPS 510 and SPG 510 were generally supportive of the new requirement for a tenure policy, with some requesting that APRA confirm expectations regarding the maximum number of terms a director can be appointed to the Board. Some submissions indicated that the maximum tenure for a director should be in the vicinity of 9-12 years (i.e. no more than three terms of three or four years). APRA's experience during this consultation, and throughout previous consultation with the superannuation sector, is that the superannuation industry requests more, rather than less, detail to be included in superannuation prudential standards and prudential practice guides (when compared with the banking and insurance industries).

The recent report 'Board Governance of Not for Profit Superannuation Funds' by Bernie Fraser recently commented that the requirements outlined in revised SPS 510 "seem sound and conducive to achieving further incremental improvements in Board governance" (refer to page 22).

The new paragraphs on tenure are closely aligned with the *ASX's Corporate Governance Principles and Recommendations* and APRA's *Prudential Standard CPS 510 Governance*, which applies to the banking and insurance industries.