AUSTRALIAN INSTITUTE of SUPERANNUATION TRUSTEES

Improving Accountability and Member Outcomes in Superannuation

11 August 2017

AIST Submission

ABN 19 123 284 275

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AIST

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the $700 billion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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Executive summary

- AIST supports measures that strengthen the obligation on superannuation trustees to consider the appropriateness of their MySuper product offerings, *provided* this assessment does not reduce the existing legislative focus on the pursuit of optimal net returns.

- We oppose any displacement or dilution of pursuing net returns for MySuper products. AIST instead support a two-tiered outcomes assessment with a *primary* annual MySuper outcomes assessment based on net returns and a *secondary* annual MySuper outcomes assessments having regard to the factors identified in the draft Bill, provided the pursuit of these are not in conflict with the pursuit of net returns.

- We oppose the factors for the annual MySuper outcomes assessment being open-ended.

- We support the extension of the assessment to all APRA-regulated superannuation products. While we agree that MySuper products should be held to the highest standards of accountability and transparency, we believe that this standard should apply equally across all parts of the superannuation system. The proposed reforms have a disproportionate impact on specific parts of the superannuation sector, and we strongly believe that they should apply on an equal basis across all sectors.

- We support measures to give APRA enhanced capacity to refuse or cancel a MySuper authorisation, although this must be subject to the financial interests of members being primarily defined as the promotion of optimal net returns.

- We support APRA's power to approve owners and controllers of RSE licensees but it must be exercised appropriately and be reviewable.

- Similarly, APRA's new directions powers must be exercised judiciously: There have been few scandals in the profit-to-member sector and APRA already has significant regulatory powers at its disposal to address many of the perceived issues.

- The directions power should be extended to cover all products issued by APRA-regulated superannuation funds.

- We are generally supportive of the proposed amendments to reporting requirements but submit more consultation is needed to address a number of issues. This is especially

important given that the Bill, if implemented, would give APRA unprecedented data collection powers.

- We support the expansion of the director penalty regime and believe it is important to that directors of superannuation funds offering Choice products are held to the same high standard.

- We support the requirement for annual member meetings, however the Bill is potentially too prescriptive and risks stifling innovation. We stress that funds should be given the freedom to choose the most appropriate engagement strategy with their members, while ensuring that such engagement occurs.

- Funds should be required to hold member meetings within 9 months of the end of a reporting period, rather than the 5 months in the Bill for the practical reasons explained in our submission.

Introduction

The Australian Institute of Superannuation Trustees (AIST) welcomes the opportunity to comment on the issues raised in the consultation paper released 24 July 2017. Our recommendations in relation to the Exposure Draft: *Treasury Laws Amendment (Improving Accountability and Member Outcomes) Bill 2017: Superannuation Guarantee (Salary Sacrifice Integrity Measures)* are contained in a separate submission.

We welcome the Government's stated objective for this draft Bill, and confirm our support for measures to improve accountability and member outcomes in superannuation. In our view, most of the measures contained in the Bill do fulfill this objective, and our overall approach in this submission is to make suggestions to further improve and strengthen the system.

The package of reforms relating to improving accountability and member outcomes in superannuation covers seven main areas, each of which will be dealt with in turn in this submission.

The areas are:

- Annual MySuper outcomes assessment.
- Authority to offer a MySuper Product.
- Director penalties.

- Approval to own or control a registerable superannuation entity (RSE) licensee.
- Australian Prudential Regulation Authority (APRA) directions powers.
- Annual members' meeting.
- Reporting standards.

Annual MySuper outcomes assessment

AIST supports measures that strengthen the obligation on superannuation trustees to consider the appropriateness of their MySuper product offerings, provided this assessment does not reduce the existing legislative focus on the pursuit of optimal net returns.

We agree it is appropriate for trustees to undertake this assessment on an annual basis, and for this to be based on promoting the financial interests of MySuper members. While the Bill expands the range of factors trustees must consider in assessing the quality and appropriateness of their MySuper products, AIST urges caution about the manner in which this is done.

In order to ensure that retirement outcomes for MySuper members are maximised it is vital that an assessment of long term net returns be maintained as the principle factor that should be considered in the assessment. The assessment of net returns should not be supplanted, or diluted, by the range of additional factors identified in the Bill.

Our main concerns are:

- The interests of members must be put first. This means that what members actually receive (net returns) must be given priority. The outcomes assessment does not give sufficient weight to the net returns.
- The superannuation system is still maturing which means it is vital to continue focusing on net-returns for members. It is important to avoid supplanting or deferring this focus as the system matures.
- MySuper products have delivered outcomes to members and while greater scrutiny of the MySuper part of the system is appropriate, it should not be at the expense of focusing on Choice aspects within the superannuation system.
- The outcomes assessment does not apply equally between MySuper and Choice products and the provisions in the Bill should be reviewed to ensure that they apply equally to all superannuation products, in order that best practice and standards can be delivered across the industry.
- The MySuper outcomes assessment should be made in writing and publicly available. The same should apply to Choice.
- The outcomes assessment should have a more appropriate process.

- Choice investment options have more member money invested in them than MySuper products, and receives the benefit of the same taxation concessions, yet is not as accountable as MySuper in terms of either reporting or disclosure. The result has been that Choice has higher fees and under-performs.

System maturity

The Explanatory Memorandum assumes that the system is at a higher level of maturity than is actually the case. The suggestion that the system will reach maturity in the next decade as "*Australians will have received compulsory superannuation contributions for most or all of their lives*" is misleading and premature.[1]

Most employees only received superannuation contributions since 1992, at an initial Superannuation Guarantee (SG) rate of 3% with this increasing at a slow rate until it reached the current level of 9.5% in 2014. Legislated increases to 12% are proceeding at an even slower rate, with 12% to be reached (subject to no further government delays) by 2025.

This means that, other than people in their twenties, many employees have received SG contributions at a low rate for most of their working life. Most commentators seem to agree that the system is unlikely to reach maturity for about another twenty years.[2]

While we agree it is time to start looking seriously at the requirements for the post-retirement system, we also believe that continued development and enhancement of arrangements for the accumulation stage should be given the highest possible priority.

System performance

AIST takes issue with the statement in the Explanatory Memorandum that "*At present the system is not consistently delivering*."[3]

While we do not disagree with this statement if the subject matter of this Bill was about the provision of financial advice or the relationship of retail funds with their related party organisations, this Bill – and particularly the annual MySuper outcomes assessment – has a particular focus on MySuper products. That statement is not correct in relation to MySuper products.

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[1] Explanatory Memorandum, *Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017*, 3 [1.5].
[2] Deloitte, *The Dynamic of a $9.5 trillion Australian Super System,* (17 November 2015) <http://tinyurl.com/y9wnxg3c>.
[3] Explanatory Memorandum, *Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017*, 3 [1.9].

Research[4] commissioned by AIST in 2016 found that profit-to-member funds (whose median growth and balanced investment options primarily became MySuper options for most Australians) generally outperformed every other category of similar Choice investment options over a 10 year period. The research also found that in addition to generally underperforming, Choice investment options in the for-profit sector (mainly run by banks) were between 53% to 280% more expensive.

AIST continues to voice its concerns that the Choice sector is continually being 'let off the hook' in terms of both reporting and disclosure, with a resultant underperformance in optimizing members' retirement savings.

The same report also demonstrates the positive impact of MySuper products on fee levels, with the report concluding that[5]:

> *Unlike the fee reductions seen within MySuper products during 2014, Choice products have shown minimal changes to fee structures in recent years, with only small decreases being witnessed.*

The report goes on to note that the median MySuper fee is $78 + 0.83% of the account balance across all funds in the survey, well less than the median fees for all Choice categories (with the exception of the lower-performing diversified fixed interest and cash).

In addition to this clear expression of the default system working, the ongoing implementation of the Stronger Super package of measures demonstrates a system that is delivering on a widespread basis:

- MySuper products able to be offered from 1 July 2013, with the final transition of default accounts in July 2017.
- SuperStream used for data and e-commerce standards from 2013, with an ongoing program of improvements and new initiatives. Current savings estimated at $2.4 billion per year.
- Operation of new APRA new prudential and expanded reporting standards for superannuation since 2013 has improved accountability and standards in the system.

MySuper has delivered better outcomes than Choice products and while we strongly agree that it is important to focus on MySuper, given its default nature, it is imperative that this is not at the

[4] SuperRatings (2016). Australian Institute of Superannuation Trustees: Fee and performance analysis. December 2015. [online] 2016: Australian Institute of Superannuation Trustees, pp.18-20. Available at: http://tinyurl.com/h6sgcth [Accessed 7 Aug. 2017].
[5] SuperRatings (2016) as cited in a previous footnote, p. 5.

expense of focusing on Choice products that also have a significant number of members and assets.

Inconsistent application of requirements across products must cease

While AIST agrees that super funds should be held to the highest standards of accountability and transparency, this is self-evidently not applying on an equal basis across all superannuation sectors. Choice superannuation products do not have the same high standards that apply to MySuper products.

The following is an outline of the differential treatment between Choice and MySuper products:

- The requirements of section 29VN(a) to (d) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) do not apply to Choice products
- There is no current requirement for Choice products to publish a product dashboard.
- The proposal does not include that the proposed annual MySuper outcomes assessment should apply to Choice products.
- There are no explicit duties on trustees to promote the financial interests of beneficiaries or currently apply a scale test for Choice products. We note there are over 40,000 Choice investment products which we believe have developed, in part, because they are not brought to account through suitable disclosure and reporting requirements.
- There is no requirement to produce a shorter product disclosure statement for legacy Choice products.

While we agree that high standards should be consistently applied across the financial system, this should also mean that high standards are also consistently applied within and between superannuation products.

AIST submits that the provisions in the Bill be reviewed to ensure that they apply equally to all superannuation products, in order that best practice and standards can be delivered across the board.

AIST submits that a clear focus on maximising retirement outcomes for members must be maintained for MySuper and – consistent with the sole purpose test – applied to all APRA-regulated superannuation products.

The outcomes test (as is currently the case with the scale test) applies only to MySuper products and not Choice products. Our submission seeks the application of an outcomes test to all APRA-regulated superannuation products.

The outcomes test risks ignoring the importance of net returns

We are concerned that the proposed annual MySuper outcomes assessment reduces the focus on pursuing long term net returns in MySuper products, and submit that this is at odds with the objective of MySuper. Indeed, ignoring the importance of net returns is at odds with the MySuper objectives.

In the short covering letter from the Super System Review, the review panel stated that MySuper sat at the heart of their recommendations:

It is designed to focus funds on the core purpose for which they exist: optimising retirement incomes for members[6].

Section 29VN of the SIS Act sets out additional obligations of a trustee in relation to a MySuper product. Sub-section 29 VN(a) requires a trustee to:

> *…promote the financial interests of the beneficiaries of the fund who hold the MySuper product, in particular returns to those beneficiaries (after the deduction of fees, costs and taxes).*

This requirement is not qualified by existing sub-section 29VN(2). Rather, the sub-section requires trustees to undertake an annual comparison with other funds that offer a MySuper products, having regard to scale of members and scale of assets.

The Bill proposes the deletion of sub-section 29VN(2) and adds new requirements for trustees (new sub-sections 29VN(2)(3) and (4)). These new requirements define the factors to be taken into account by trustees in determining the financial interests of MySuper members, and reinsert the scale comparison.

While returns are identified as a factor (proposed new sub-section 29 VN(3)(c)), it would be one factor in a list of many factors. The consequence of these changes is that the current clear legislative requirement to pursue optimal net returns is diluted and diminished.

AIST strongly supports a clear and unclouded legislative requirement for trustees to pursue net returns for MySuper members, and opposes any legislative prescription that reduces this requirement.

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[6] Super System Review Final Report, *Part One: Overview and Recommendations,* (10 August 2017) <http://tinyurl.com/zfewy9q>

AIST supports a requirement for trustees to undertake an annual comparison of long-term net returns with other funds that offer a MySuper product, but does not insist that this be on the basis of a scale test.

AIST supports a legislated requirement to compare long-term returns as the primary obligation of a trustee in relation to a MySuper product, and for this to be after the deduction of fees, costs and taxes. While more work is needed, AIST notes and supports the objective of Regulatory Guide 97, which is intended to ensure that fees and costs associated with deriving net returns are captured.

AIST does not oppose a legislated requirement for trustees to consider other factors, and for these to be the factors listed in the draft Bill. However, the construction of the Bill should be amended so that the pursuit of these are not in conflict with the pursuit of net returns.

This two-level approach would maintain the focus on net returns while also allowing a more fulsome assessment of MySuper products to take place. This will assist trustees to concentrate on the overall health of their MySuper products while not reducing the primary focus on net returns.

The multi-factor approach also risks increasing complexity, lack of clarity and reduction of easy comprehension. If, however, the multi-factor is overlaid by a paramount requirement to pursue net returns, this becomes much simpler to both understand and assess as a consumer.

A consumer will therefore be able to get the answer to two questions: “What returns has my fund delivered and how does this compare to other funds?” and: “What options, benefits and facilities are offered by my fund; are they what I need; and do they offer value?”

The separation of the two questions is very important. It is likely that many members of super funds will continue to be disengaged, disinclined or unable to assess their superannuation fund. The primacy of net returns in the assessment process would ensure that the interests of these members are protected, even in the common case of these members being disconnected from other services their fund might offer.

AIST is also concerned that that the list of criteria is open-ended, as the legislation provides that the list could be extended by regulation. For example, the level of liquidity, the number of duplicated accounts, and the efficiency of fund administration could be added as matters to be compared. While there may be merit in the consideration of other factors, this should be directed towards the benefits provided to members.

The Bill does not recognise that some of these matters are already addressed in the SIS Act and by prudential standard, and does not provide a weighting for the criteria. The criteria in the proposed test are all important, but are not equally important, and none are as important as pursuing long term net returns.

AIST would oppose the alternate approach of weighting each of the criteria, as this would still involve the reduction in the focus on net returns.

Trustee determinations should be publicly available

AIST agrees that the trustee's determinations in relation to the MySuper outcomes assessment should be made in writing and publicly available. AIST further submits that the Government should make a consequential amendment to section of section 29 QB of the SIS Act to include the determination as specific information required to be made publicly available.

Given the importance of this assessment (especially if it has a primary focus on net returns), we submit that it should be prescribed in legislation rather than being prescribed by the regulations.

Proposal for modification of outcomes assessment process

We recommend that the following process be followed for the annual MySuper outcomes assessment:

- Step 1: The trustee to make an assessment of the long term net returns of its MySuper product.
- Step 2: The trustee to compare the long term net returns of their MySuper product against the long term net returns of other MySuper products.
- Step 3: The trustee to make an assessment of the appropriateness of the other factors prescribed in the legislation of its MySuper product to their beneficiaries.
- Step 4: The trustee to compare the other factors of their MySuper product against the other factors of other MySuper products.
- Step 5: The trustee to make an assessment of the impact, if any, of the other factors on the long term net returns of its MySuper product.
- Step 6: The trustee to make an overall determination based on the above assessment, and for this to be publicly available.

Authority to offer a MySuper product

We support the measures to provide APRA with enhanced capacity to refuse or cancel a MySuper authorisation, subject to the financial interests of members being primarily defined as the promotion of optimal long term net returns.

Relationship to annual MySuper outcomes assessment

Our comments in relation to this chapter are to be read in the context of our position on the annual MySuper outcomes assessment in the Bill outlined above.

We support the requirement for the trustees of superannuation funds to be held to a high standard, especially in those circumstances where members do not actively participate in the management of their superannuation interests. This requirement and the higher standards applicable to trustees offering a MySuper product are entrenched in the existing provisions of the SIS Act.

AIST supports the proposed requirements for APRA to be able to ensure that trustees offering a MySuper product are able to provide products of sufficient quality to promote the financial interests of members, where the pursuit of optimal long term net returns are the primary objective and other factors are secondary.

We would oppose an outcome where APRA was able to refuse or cancel a MySuper authorisation because the trustee did not offer a wide range of features to members of MySuper products, notwithstanding their delivery of optimal net returns to these members.

Given that most MySuper members are not involved in the direct management of their super, there can be limited benefits in providing members with a wide range of products and services that they may not be aware of, want or need.

It is the responsibility of trustees to assess the nature of their members with a MySuper interest, and determine what range of other features are appropriate in their circumstances. This assessment may result in the offering of a wide or a narrow range of features, but should always (in AIST's view) be subject to confirmation that the offering of these features is not inconsistent with the pursuit of optimal long term net returns.

Enhanced APRA powers

Subject to the concerns expressed in the previous section, AIST does not oppose the proposal to give APRA increased authority in relation to the authorisation of a MySuper product, including the change in the assessment test from 'is likely to' to 'no reason to believe.'

We believe that these increased requirements will further entrench the position of MySuper products as the 'gold standard' of superannuation products. AIST agrees with the assertion in the Explanatory Memorandum that these measures should improve the quality of MySuper products, and recommends the extension of higher requirements to other superannuation products.

The profit-to-member ethos promoted by AIST and our member funds will be enhanced by these changes, as consumers will be able to have even higher confidence in the MySuper products offered by our member funds, supported by these protections.

AIST notes that the proposed changes relate to specific sub-sections of sections 29T and 29U of the SIS Act, and that the other requirements concerning the authority to a MySuper product and the cancellation of MySuper authorisation remain.

Strengthening APRAs supervisory and enforcement powers

The proposed reforms aim to strengthen APRAs supervisory and enforcement powers and will ensure APRA can take preventative and corrective action against industry participants when necessary. The purpose of these changes, in part, is to increase consumer confidence within the system.

We believe:

- APRA's power to approve owners and controllers of RSE licensees must be exercised judiciously and be merits reviewable.
- APRA's new directions powers should also be exercised judiciously because there have been few scandals in the profit-to-member sector and APRA already has significant regulatory powers at their disposal to address many of the perceived issues.
- The directions power should be extended to ensure equal coverage across industry sectors.
- AIST strongly supports the collection and analysis of data which would help APRA review the impact of related-party costs, as well as the delivery of fair value to members. Notwithstanding this support, there are a number of issues that must be addressed first.

Approval to own or control an RSE licensee

The legislative amendment proposes to require persons (including corporations) to apply to APRA to own, or hold, a controlling stake[7] in an RSE licensee. APRA will also have the power to intervene where they think a person, group of persons, or a company has practical control of the RSE licensee.

APRA will be given a wide variety of powers, in particular:

- Deny a change in ownership where it has concerns about the new owner;
- Give a person, group of persons, or company a direction to relinquish their control of the RSE licensee in certain circumstances;
- Remove or suspend an RSE licensee where it is subject to control of its owner.

[7] *Superannuation Industry (Supervision) Act 1993 (Cth)* proposed s 10(1) defines controlling stake as a shareholding in the RSE licensee of more than 15%.

The exercise of these new powers could significantly impact the operations of the RSE licensee and its staff. As such, we believe it is imperative that the power is exercised judiciously and only after a full consideration of relevant circumstances. We submit that the decision be reviewable, as outlined in the Bill, and that this right is not replaced or removed.

In the Bill a person affected by APRA's decision to refuse to give approval to hold a controlling stake in the RSE licensee, or direction to a person to relinquish control can:

- Request the regulator reconsider the decision;[8]
- Apply to the Administrative Appeals Tribunal for a merits review of the decision.[9]

We submit it is imperative that these rights be maintained.

Directions power

The draft Bill proposes to amend the SIS Act to bolster APRA's supervision and enforcement powers over RSE licensees. The Explanatory Memorandum outlines that the new powers are necessary to allow APRA to respond to issues in a variety of circumstances, not all of which can be foreseen.[10]

While we believe it is important for regulators to have sufficient and appropriate powers to protect members' interests, and ensure compliance with RSE licensee laws and prudential standards, the extra powers must be exercised judiciously because:

- There have been few scandals in the profit-to-member superannuation sector and heavy involvement by APRA in the operation or management of funds has been rare.
- Trustees operating under a profit-to-shareholder model, within vertically integrated business structures, face greater prudential risks than those trustees operating within profit-to-member sector.
- APRA has a significant and adequate regulatory tool-box, which allows it to achieve the stated objective in the Explanatory Memorandum that the powers are needed '*to facilitate intervening at an early stage to address prudential concerns within a fund.*'[11]

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[8] *Superannuation Industry (Supervision) Act 1993 (Cth)* s 344(1).
[9] *Superannuation Industry (Supervision) Act 1993 (Cth)* s 344(8).
[10] Explanatory Memorandum, *Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannaution) Bill 2017*, 41 [6.3].
[11] Explanatory Memorandum, *Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannaution) Bill 2017*, 41 [6.2].

APRA already has wide-ranging directions powers that empower it to monitor and, if appropriate, address the conduct of RSE licensees. These powers are provided through the SIS Act and specifically through enforceable conditions that apply to each RSE licensee.

The focus should be on improving the regulatory framework overall, so that APRA is better equipped to carry out its supervisory functions, particularly in relation to Choice products.

This table outlines APRA's current regulatory tool-box.

Proposed directions power affecting RSE licensees	**Existing APRA power that can address the issue**
Directions to comply with regulatory or prudential obligations	APRA has the power to issue a direction to an RSE licensee if APRA has reasonable grounds to believe that the RSE has breached a condition of their licence.[12] Licence conditions include a requirement for the RSE licensee to comply with RSE licensee law, which includes the SIS Act, regulations, prudential standards and other legislation.[13]
Protect interests of beneficiaries	APRA has extensive powers that culminate in the protection of the interests of beneficiaries, for example APRA can: • Investigate the RSE licensee if the SIS Act, regulations, or prudential standards may have been contravened. • Appoint an inspector to investigate the affairs of a superannuation entity.[14] • Issue infringement notices and impose penalties under those notices.
Directions to address certain financial risks, including preventing the RSE licensee from receiving contributions, borrowing, paying	APRA already has a wide suite of powers available where these concerns are live, for example APRA can investigate an RSE

[12] *Superannuation Industry (Supervision) Act 1993 (Cth)* s 29EB (a)–(b).
[13] *Superannuation Industry (Supervision) Act 1993 (Cth)* s 29E(1)(a) read with section 10(1).
[14] *Superannuation Industry (Supervision) Act 1993 (Cth)* s 265(1).

or transferring money or assets, undertaking financial obligations and similar.	licensee if they believe the financial position of the superannuation entity may be unsatisfactory.[15] APRA can also issue directions about acquiring or disposing of assets, or a freezing of assets if the entity's conduct is likely to adversely affect the interests of beneficiaries.[16] Under Part 17 of the SIS Act APRA has extensive power to suspend and replace a trustee. The grounds for suspension are broad, which enables APRA to use this power to address financial risks.[17]
Direction to the RSE licensee to remove a responsible officer	APRA has power to disqualify individuals that are, or were, responsible officers of trustees.[18] Prudential Standard SPS 520 – Fit and Proper ensures RSE licensees meet minimum requirements for the fitness and proprietary of individuals to hold certain positions of responsibility.
Direction to order the audit of the affairs of the RSE licensee or RSE	APRA can require the trustee to appoint an individual to investigate the whole or specified part of the financial position of the entity and make a report on this investigation.[19] Prudential Standard SPS 510 – Governance, paragraph 53 states that the board audit committee must ensure the adequacy and

[15] *Superannuation Industry (Supervision) Act 1993 (Cth)* s 263(1)(b).
[16] *Superannuation Industry (Supervision) Act 1993 (Cth)* s 264 (1)–(5).
[17] *Superannuation Industry (Supervision) Act 1993 (Cth)* part 17.
[18] *Superannuation Industry (Supervision) Act 1993 (Cth)* s 126A (1)–(3).
[19] *Superannuation Industry (Supervision) Act 1993 (Cth)* s 257 (1)(a)–(b).

	independence of both internal and external audit functions. Prudential Standard SPS 310 - Audit and Related Matters sets out a number of internal and external auditor requirements that RSE licensees must adhere to, as well as the prescribed content of the audit. RSE licensee auditors must be approved within the meaning of the SIS act, to ensure no disqualified auditors can audit a fund. Prudential Standard SPS 220 – Risk Management requires RSE licensees to implement satisfactory internal and external audit arrangements. There is a positive obligation on auditors and actuaries to inform the regulator in writing if they identify any contraventions of the SIS legislation or the *Financial Sector (Collection of Data) Act 2001* (FSCDA) may have occurred.[21] This notification requirement ensures the regulator can act as soon as practicable if necessary.
Direction to order an actuarial investigation of the RSE licensee or RSE	There is a positive obligation on auditors and actuaries to inform the regulator in writing if they identify any contraventions of the SIS legislation or FSCDA may have occurred.[22] This notification requirement ensures the regulator can act as soon as practicable if necessary.

[21] *Superannuation Industry (Supervision) Act 1993 (Cth)* s 129(3).
[22] *Superannuation Industry (Supervision) Act 1993 (Cth)* s 129(3).

	Prudential Standard SPS 160 - Defined Benefit Matters, paragraph 14, sets out extensive obligations on RSE licensees to, inter alia, appoint RSE actuaries to undertake and report on actuarial investigations at regular intervals.

Directions power and connected entities:

The proposed directions powers also would enable APRA to give a direction to a connected entity. A connected entity, in relation to a RSE licensee, is a subsidiary of that RSE licensee and any other entity of a kind prescribed by the regulations.[24]

While we support the proposed extension of the directions power, the extension to connected entities is not broad enough, as it does not enable APRA to address the conduct of entities that are not subsidiaries of the RSE licensee, but nevertheless have a close connection with the RSE licensee. Typically, superannuation funds that are part of a vertically integrated structure with a parent entity use the services of related parties that are also within the business structure, but are not actually a subsidiary of the RSE licensee. In these circumstances the proposed power would do very little to protect the interests of beneficiaries should the conduct of a related entity be errant.

While we support the expansion of the directions power to cover connected entities, the current provision is fundamentally flawed because it does not have consistent application across sectors of the superannuation industry –notably, superannuation funds operating in a retail environment would attract less scrutiny.

It is imperative, for comparability and equal protection of members' interests, that there is consistent coverage of the power across the system.

In summary, while we do not believe that the additional directions powers are necessary we do not oppose the measures outlined in the Bill. We believe it is imperative that there is consistent application of standards across all sectors of the superannuation industry. As such, the power to issue a direction to connected entities must be reviewed to ensure parity between industry sectors.

Finally, the additional powers underline the high degree of regulation that applies to superannuation funds and should give consumers confidence in the integrity of the system.

[24] *Superannuation Industry (Supervision) Act 1993 (Cth)* s 10(1).

Reporting standards

We strongly support the collection and analysis of data which would help APRA review the impact of related party costs, as well as the delivery of fair value to members and we support the development of a robust *data collection and use* framework. Such a framework could greatly assist with the prioritisation of, and the assessment of the need for, the collection of any new data. This is especially important given the administrative impact on superannuation funds, as well as the (we believe) unprecedented ability of APRA to collect details of any expenditure to any entity which would be provided if the Bill is enacted. The proposed amendments to the *Financial Sector (Collection of Data) Act* 2001 (FSCODA) would provide APRA with very broad powers.

Notwithstanding our general support:

- APRA must conduct another in-depth assessment of the impacts of related party costs, similar to the assessment performed in 2010.
- There is a lack of clarity around key areas of the reporting reforms.
- Existing issues regarding APRA reporting must be resolved prior to the amendments proceeding. These include the implementation of Regulatory Guide 97, Disclosing fees and costs in PDSs and periodic statements, as well as the alignment of MySuper and Choice reporting.
- The development of a data collection and use framework must have regard to the factors outlined below.
- There are a number of ongoing reviews and regulatory reforms that impact the collection of data by APRA. The actual and likely impact of these reviews and reforms must be assessed in the context of the proposed reforms.
- Our concerns regarding the proposed amendments to FSCODA must be addressed.

Related party cost analysis

We strongly support the collection and analysis of data which would help APRA review the impact of related party costs, as well as the delivery of fair value to members. AIST has long called for the updating of APRA's 2010[25] report on the impacts of related party costs. This is needed before any review of the efficiency and competitiveness of the superannuation system can take place.

[25] Australian Prudential Regulation Authority, *Working Paper: Australian Superannuation Outsourcing – Fees, Related Parties and Concentrated Markets* (12 July 2010) <http://tinyurl.com/hkmhken>.

Lack of clarity

There is a general lack of clarity around key areas in the reporting proposals. We would greatly appreciate further consultation because the industry has only had several weeks to assess proposals which, while we are generally supportive, are unclear.

Reporting priorities

While supportive of the general direction in the proposed amendments to FSCODA, AIST believes that there are two more immediate APRA reporting issues which need to be resolved first:

- The alignment of MySuper and Choice reporting, which is needed to ensure the competitiveness and efficiency of the superannuation system.
- Resolution of fee and cost reporting flowing from the implementation of Regulatory Guide 97, *Disclosing fees and costs in PDSs and periodic statements*.

Any data collection and use framework must be developed appropriately

We believe that a robust *data collection and use* framework would greatly assist the superannuation sector to better contextualise reporting to APRA. The need for such a framework is extremely important, especially in light of what we believe is the unprecedented ability to collect data relating to any expense paid to any entity.

We call for the development of such a framework, which could cover the following:

- Objectives for data collection and reporting;
- Principles for determining the importance of calls for new data reporting;
- The relevance of the data being collected;
- How the data will be analysed and used;
- How confidentiality of certain data will be maintained;[26]
- Data mapping and the need for agencies to justify why they require the data in a different format.

Determining the impact of ongoing reviews and regulatory reforms

We note that there are a number of reviews and regulatory reforms which impact the collection of data by APRA:

[26] We note that the OECD principles for regulation include that data should be maintained and delivered in a manner that takes full account of their potentially confidential nature. <http://tinyurl.com/ybzhulvv>.

- The Productivity Commission reviews which recommend the establishment of efficiency criteria;
- Regulatory Guide 97;
- Treasury consultations regarding design and distributions obligations and product intervention power.

AIST calls for the impact of these reviews and reforms to be assessed within the context of a data collection and use framework. It is extremely difficult for superannuation funds to assess the administrative impact without examining all of these issues together.

FSCODA

We reiterate our general support, but there is insufficient clarity from the proposals to be able to assess their impact. Our concerns regarding the proposed amendments to FSCODA include:

- The Bill would give APRA the power to stipulate that payments to any type of "entity" (undefined) be reported. While we appreciate that it has been difficult in the past to suitably define "related party" and that this has perhaps driven the use of a very broad term, we seek clarity.
- There is no clarity regarding the grouping, use, and confidentiality of management and operational expenses.
- We query whether a Regulatory Impact Statement which takes into account administrative impact on funds has been prepared.
- It has taken the industry a long time to resolve the level of 'look-through' with Regulatory Guide 97. Accordingly, we seek consultation regarding what level of 'look-through' the proposed amendments to FSCODA envisage.

Finally, we query how APRA might use the data regarding possible interventions into the operational and management decisions of superannuation funds.

In summary, while we support the general direction of the proposed amendments to FSCODA, further consultation with industry is needed.

Director penalty regime

The Bill proposes to allow the imposition of civil and criminal penalties on directors in two main circumstances:

- For contravention of a covenant that is, or is taken to be, in the RSE licensee's governing rules; and

- For contravention of an obligation that is, or is taken to be, in the RSE licensee's governing rules that relates to MySuper Products.

We support the expansion of the director penalty regime and believe it is important to consider whether directors of superannuation funds that offer Choice products are being held to the same standard. If not, we believe they should be.

Contravention of a covenant

Profit-to-member funds are committed to advancing the best interests of their members and the fund returns all investment earnings to their members. The governance arrangements within the profit-to-member sector are robust and contribute towards a positive member-first ethos. While we support the proposed director penalty regime measures, we note that poor conduct on behalf of directors has largely been a non-issue for the profit-to-member sector.

Furthermore, the introduction of a civil and criminal penalty regime for directors under the SIS Act does not significantly alter the status quo, as directors of superannuation funds are still required to have regard to the codified duties in the *Corporations Act 2001 (Cth)* and those in general law.

Contravention of MySuper obligations

Directors of RSE licensees that offer a RSE that offers a MySuper product have enhanced director obligations. The directors must ensure that they personally exercise a reasonable degree of care and diligence for the purposes of ensuring that the trustee carries out the additional obligations for trustees in relation to MySuper products.[27]

The amendments propose to make a contravention of this duty a civil penalty provision that may give rise to criminal consequences.[28]

We are supportive of this measure, however it should be considered whether directors of superannuation funds that offer Choice products should be held to the same standards.

Annual members' meeting (AMM)

We support the requirement for AMMs, however the Bill is potentially too prescriptive and this risks stifling innovation. We stress that funds should be given the freedom to choose the most appropriate engagement strategy with their members.

[27] *Superannuation Industry (Supervision) Act 1993 (Cth)* s 29VO.
[28] Explanatory Memorandum, *Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannaution) Bill 2017*, 20 [4.10].

One of the stated objectives of the exposure legislation is to increase confidence within the superannuation system, and ensure it continues to deliver outcomes for members. The Explanatory Memorandum notes:

> *The current framework is not holding funds to the highest standards of accountability and transparency, to the detriment of members.*[29]

One such way the Bill proposed to increase accountability and transparency is by requiring RSE licensees to hold an AMM. We strongly disagree with the comment in the Explanatory Memorandum which states that in most cases members have little or no ability to ask questions of their funds.[30] Many profit-to-member funds already have active member engagement programs in place, including annual member briefings, and these vary depending on the particular membership demographic of the fund, business mix and overall strategy.

AIST agrees that fund transparency and accountability is vital, and supports measures to continually improve engagement with fund members. This is demonstrated in the AIST Governance Code, Requirement 5.1 of which reads:

> *"A profit-to-member super fund must develop and implement a stakeholder engagement program, for effective disclosure of relevant and material issues. The program must provide opportunities for directors and senior management to communicate directly with stakeholders and for stakeholders to ask questions of them."*[31]

We believe that providing an avenue for members, and other stakeholders, to directly engage with the RSE licensee and ask questions is an effective way for the fund to identify and respond to issues that are of interest to their members and stakeholders.

While we support mechanisms aimed towards promoting engagement with super fund members and increasing visibility of fund operations, there is a need to ensure that the regulatory burden and costs associated with the mechanisms are managed and that funds are given flexibility to determine the most appropriate engagement strategy and avenue based on the needs of their members.

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[29] Explanatory Memorandum, *Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017*, 4 [1.9].
[30] Explanatory Memorandum, *Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017*, 61 [7.3].
[31] Australian Institute of Superannuation Trustees, *AIST Governance Code* (12 April 2017) <http://tinyurl.com/ybd6aaol>, 20.

There is a large degree of prescription in the Bill, and we believe that this should be minimised where possible. The table below illustrates the extent of the prescription.

Subject matter	Proposed provisions	Response
Timing	Meeting must be held within 5 months after the end of the year of income for the entity.	We submit that the meeting be held within 9 months of the end of the reporting period (see further comments below) We understand this requirement is similar to that in the Corporations Act 2001 regarding Annual General Meetings. For the avoidance of doubt we believe that the Bill should outline that it is permissible for RSE licensees to hold multiple meetings potentially in various locations.
Notice	RSE licensee must give notice to specified persons at least 21 days before the meeting.	The Bill must clarify the meaning of 'notice' and the notice requirement should be able to be satisfied through a publication of the meeting on the RSE's website, and in the Annual Report (if appropriate).
Content of Notice	The notice must include details of meeting location, how meeting can be attended electronically, agenda of matters to be discussed, and annual report.	The Bill should outline that the content must be in plain English.

Conduct of annual members' meeting	Provisions specify the kind of questions that members can ask the RSE at the meeting.	
Minutes	Provisions specify how minutes are to be released.	
Obligation for specified parties to attend	Provisions outline who must attend the meeting, and includes responsible officers, auditors and actuaries.	
Obligation for specified parties to answer questions	Provisions outline requirements for specified parties to answer questions at the meeting and if this is not practicable, to answer on notice within a specified timeframe.	

We believe that extensive prescription, and the requirement to hold an AMM in the current format, may increase costs. While some funds currently have a member engagement program, which runs on a cost-effective basis, the Bill may introduce additional cost burdens. These costs will ultimately be borne by members, and we believe that flexibility is necessary in order to ensure the trustee can develop a program that is suitable to their membership base and member needs.

We believe that the overly prescriptive nature of the requirements risks stifling innovation, something that can be seen in the context of Annual General Meetings, with groups calling for a relaxation of legislative rules around issues such as virtual meetings.[32] We support the requirement for AMMs, however stress that funds should be given the freedom to choose the most appropriate engagement strategy with their members. Ultimately the trustee is in the best position to determine the needs of their members and the best way to engage with them.

[32] Australian Institute of Company Directors, *The Future of the AGM: Don't Throw the Baby Out with the Bathwater* (December 2016) <http://tinyurl.com/yc6ecbdr> 5.

Timing

AIST believes there are practical reasons why the member meeting should be held within 9 months of the end of the reporting period, rather than the 5 months prescribed by the Bill, and seeks that the legislation be amended accordingly.

Proposed sub-section 29P(4)(b)(i) would require the annual report of the RSE to be included with the notice of meeting, while proposed sub-section 29P(3) requires at least 21 days notice.

These requirements would effectively reduce the time available for super funds to circulate annual reports and periodic statements to their members.

Sub-regulation 7.9.32(3) of the Corporations Regulations requires periodic fund statements and fund information (the annual report) to be circulated within 6 months after the end of the relevant reporting period. This enables super funds to complete the annual report process in a reasonable period and to stagger the distribution of this documentation to members. This is particularly relevant to large funds, where funds may have up to two million members. Staggered mail outs means that funds and administrators can efficiently respond to member enquiries arising from the mail out.

It is anticipated that, on both efficiency and effective communications grounds, many funds would give notice of the annual member meeting in their annual report distributed with periodic statements.

A 5 month requirement in this Bill would mean that the annual report would need to be completed within 4 months of the end of the relevant period (ie, 4 months plus at least 21 days). The administrative and investment-related processes of finalising year end can take two to three months, meaning that a 4 month timeframe would be unreasonably short, would significantly increase costs of funds, and would lead to unsatisfactory member experiences.

As most funds operate on a 30 June year end basis, it is submitted that a 9 month requirement would then give these funds until the end of March to hold their member meetings. AIST submits that it would be an unreasonable requirement on funds and inconvenient scheduling for members for AMMs to be necessarily held in January or February.