

Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Budget Estimates

2016 - 2017

Division/Agency: Australian Prudential Regulation Authority

Question No: 159

Topic: Accrued Default Amounts

Reference: Written

Senator: Ketter, Chris

Question:

1. What is the total value of accrued default amounts (ADAs),
2. What is the number of member accounts that include ADAs, and
3. What is the variation of rate of transition of ADAs to MySuper products between fund segment types?
4. How does APRA monitor the transition of ADAs?
5. How is ADA transition data collected?
6. How frequently is ADA transition data collected?
7. How is ADA transition data verified?
8. What factors could reasonably affect the accuracy and how up-to-date the ADA transition data is?
9. Why is there a variation of rate of transition of ADAs to MySuper products between non-profit funds and retail funds?

During estimates on 20 October, with respect to variation of rate of transition of ADAs to MySuper products between fund segment types the APRA noted that: “because of the particular terms of trustees and other legal constraints that have meant they have had to go through perhaps some more extended processes than they thought they might need to be able to legally move members from one product to another”:

10. Can Trust Deeds, and other constraints, be changed to expedite the transition of ADAs to MySuper compliant products?
11. Can APRA confirm or clarify whether or not there is an expectations that transition of ADAs to MySuper compliant products occur at the earliest opportunity where it is in the best interests of beneficiaries to do so? If not, why not?
12. In APRA’s view, where a fund is earning higher fees as a result of delaying the transition of ADAs to MySuper compliant products, is this a breach of the fund trustee’s duties to act in the best interests of members and manage conflicts?
- If this is a breach, what are the consequences? For the Trustees? For the fund?
13. What activity is APRA undertaking on this issue?

A substantial proportion of assets in the superannuation system are legacy products; does APRA hold data on:

14. The value of funds in legacy choice products?
15. The number of member accounts in legacy choice products?
16. The net returns of legacy choice products?
17. The average fees for legacy products?
18. The range of fees for legacy products?

19. Why do funds leave members in legacy choice products?
20. Where a fund earns higher fees because a member is in a choice legacy products, does this conflict with the trustee's duties? If yes, what are the consequences of this?
21. What powers, if any, does APRA have to address such a conflict with a trustees duties?
22. Does current legislation allow APRA to intervene where there is a conflict with a trustees duties?
23. Do other powers or instruments allow APRA to intervene where there is a conflict with a trustees duties?

Answer:

1. - 13. Refer to the end for responses to these questions.

14 - 18. APRA does not collect information about legacy choice products. APRA's reporting framework instead requires RSE licensees to submit information at the following levels:

- RSE licensee level information;
- RSE (whole-of-fund) level information;
- sub-fund level information; and
- investment option level information for MySuper products and select (choice) investment options.

APRA's reporting requirements do not differentiate between legacy and non-legacy products.

19. Legacy products generally arise for RSE licensees in the normal course of their business as product development cycles and ongoing competition for new superannuation business mean that decisions are regularly made to close products to new members. Products that were established long before the introduction of MySuper (up to 20 years before, in some instances) and which the RSE licensee didn't anticipate would need to be replaced with MySuper-quality products can pose significant transition issues. These products were generally designed on the basis that members would remain in the product until age 65, at which time the benefits would be made available to members. Significant early surrender penalties are often attached to these products making their transfer to MySuper potentially costly for members. Members who hold interests in such products can be reluctant to leave these products because of the negative financial impact on their interests from doing so, but there is no one single reason to explain why members choose to remain in legacy products.
20. RSE licensees are required, under s. 52(2) of the *Superannuation Industry (Supervision) Act 1993*, to give priority to the interests of beneficiaries over the interests of all others. Whether a decision of the trustee breaches this duty will depend on the circumstances in which the decision was made. APRA's view is that the question of whether fees charged to members of legacy products are consistent with their s. 52 obligations requires consideration of factors that are broader than just the fee levels alone. Such factors include the RSE licensee's decision making process and how it arrived at the decisions to both invest members' benefits in legacy products and ongoing considerations of the maintenance of legacy products, including the impact on members by closing the product.

21. – 23. A breach of any provision of the SIS Act allows APRA to issue a direction to the RSE licensee to direct them to comply. A beneficiary that has suffered loss or damage as a result of a breach of a covenant in s. 52 can also take action against the RSE licensee (refer to s. 55 of the SIS Act). APRA also has significant powers under the SIS Act to direct, suspend or remove an RSE licensee as well as powers to apply for disqualification of individuals and appoint an acting trustee.

The following is in response to Questions on Notice:

- 156 (SQ16-001155)
- 157 (SQ16-001159)
- 158 (SQ16-001160)
- 159 (SQ16-001165) (Questions 1 to 13).
- 500 (SQ16-001546)
- 501 (SQ16-001547).

Sections 387 and 388 of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) requires accrued default amounts to be transferred to a MySuper product before 1 July 2017. In doing so, RSE licensees are required to comply with the requirements of *Prudential Standard SPS 410 MySuper Transition* (SPS 410).

SPS 410 requires all RSE licensees that have accrued default amounts (ADAs) within their business operations to put in place a transition plan for moving those ADAs to an authorised MySuper product by 1 July 2017. To assist RSE licensees with this process, APRA has developed *Prudential Practice Guide SPG 410 MySuper Transition*.

Transition plans have been submitted by all RSE licensees with ADAs within their business operations.

APRA reviewed these transition plans when they were first submitted and is continuing to monitor RSE licensee progress against these plans where ADAs remain to be transferred. APRA is satisfied that all ADAs will transition to MySuper products by 1 July 2017 (the timeframe permitted by the legislative framework).

RSE licensees are required, under s. 52(2)(d) of the SIS Act, to give priority to the interests of beneficiaries over the interests of all others at all times. These requirements in combination with Prudential Standard SPS 521 Conflicts of Interest are referred to as the RSE licensee's 'conflicts management obligations'. Whether a decision of the RSE licensee breaches these obligations will depend on the circumstances in which the decision was made. A breach of any provision of the SIS Act allows APRA to issue a direction to the RSE licensee to direct them to comply. A beneficiary that has suffered loss or damage as a result of a breach of a covenant in s. 52 can also take action against the RSE licensee (refer to s. 55 of the SIS Act). APRA also has significant powers under the SIS Act (in the event of very significant issues or concerns) to direct, suspend or remove an RSE licensee as well as powers to apply for disqualification of individuals and appoint an acting trustee.

APRA has no reason to consider the current legislative settings relating to the transfer of ADAs to MySuper products in a timely manner and the management of conflicts inadequate

for their purpose, or to believe that RSE licensees are not complying with the conflicts management obligations.

Notwithstanding the 2017 legislative deadline for transferring ADAs, APRA continues to emphasise to all RSE licensees with ADAs yet to be transferred, that where it is in the members' best interests to do so, ADAs should be transferred at the earliest opportunity.

APRA is aware of some scenarios where, on balance, it has been in the members' best interests to delay the transfer, for example to enable adequate and repeated communication with members about the implications of their interest being transferred to a MySuper product. This is important to allow these members the opportunity to remain in the original product if they choose to do so. Examples of scenarios where more detailed and extensive communications were considered appropriate include where members would:

- not be permitted under the fund's governing rules to re-enter the fund once they have left;
- lose access to their income protection benefits;
- receive different levels of insurance cover;
- be negatively affected by early surrender value adjustments; or
- experience fee increases.

Many RSE licensees (particularly of retail funds) sought to create new MySuper products rather than rebadge an existing default option. Where an RSE licensee with ADAs decided to create a new MySuper product, the transition plans were generally more complex and involved a longer transition period. This additional complexity and time was generally need to implement decisions to:

- establish new lifecycle MySuper products (as expressly permitted under the SIS Act);
- rationalise existing products;
- seek advice on how to best respond to legal complexities associated with exiting existing products, including how to make the necessary changes to the trust deeds to accommodate the exit of ADAs from their original products;
- undertake necessary due diligence on potential MySuper products before being able to decide to transfer ADAs to that new product; and
- create new platforms for offering their MySuper product.

Some RSE licensees have experienced difficulties when attempting to identify all ADAs, particularly where there have been multiple successor fund transfers into their fund. Under a successor fund transfer, members' balances are mapped to comparable investment options in the receiving fund, though the receiving RSE licensee does not typically receive any direction from the members regarding these allocations or whether they should be treated as a default. APRA has liaised closely with affected RSE licensees and is confident that ADAs have now been correctly identified and appropriate transition plans for their treatment put in place.

For all RSE licensees, APRA regularly monitors progress against transition plans as part of its normal supervisory activities, including off-site and on-site reviews. Where an RSE licensee has put in place a transition plan with a longer timeframe, APRA continues to review the transition of ADAs and the appropriateness of the RSE licensee's actions in taking this extended timeframe to transition. As part of this ongoing supervisory interaction, APRA seeks regular information from the RSE licensee as to why a delay is necessary, and assurances that the RSE licensee is doing everything within its power to transition on a timely basis in the best interests of members.

To monitor the movement of ADAs, APRA determined a reporting standard under the *Financial Sector (Collection of Data) Act 2001* to require the RSE licensee of an affected RSE to report the number of accounts in the affected RSE that include an ADA, and the total value of the ADAs. This information is reported to APRA within 35 calendar days after the end of each quarter. Refer to *Reporting Standard SRS 410.0 Accrued Default Amounts* (SRS 410.0) for details of these reporting obligations.

The responsible supervisor for each RSE licensee uses this data to regularly follow up compliance with the transition plan.

At 30 June 2016, there was \$41.3 billion in ADAs. This represents 3.2 per cent of total assets, compared to 21.5 per cent at September 2013. At 30 June 2016 there were 46 RSEs with an ADA, of which 18 were under the trusteeship of an RSE licensee not authorised to offer a MySuper product (10 retail funds, six corporate funds and two public sector funds).

At 30 June 2016 there were 1.7 million member accounts with an ADA, which represents around 7.1 per cent of member accounts for APRA-regulated entities with more than four members (excluding ERFs and ADFs).

At 30 June 2016, 8.0 per cent of total default assets (MySuper assets and ADAs) were held in ADAs, compared to 57.6 per cent at September 2013. At June 2016, retail funds held 7.2 per cent of total assets in ADAs, compared to 1.2 per cent for corporate funds, 0.4 per cent for public sector funds and 0.1 per cent for industry funds. Refer to the table 'Transition of accrued default amounts (ADAs) to MySuper products', for information relating to transition of ADAs over time by fund type.

Transition of accrued default amounts (ADAs) to MySuper products

APRA-regulated entities with more than four members

	Sep 2013	Dec 2013	Mar 2014	Jun 2014	Sep 2014	Dec 2014	Mar 2015	Jun 2015	Sep 2015	Dec 2015	Mar 2016	Jun 2016
Total RSE assets (\$bn)¹												
Corporate	63.0	64.0	62.1	56.5	57.5	53.6	56.6	54.1	53.6	54.1	53.7	54.9
Industry	335.8	354.1	361.5	376.1	387.9	403.1	436.8	434.1	431.3	445.6	446.5	466.2
Public sector	178.0	186.8	189.6	195.7	201.1	208.8	221.0	219.5	220.1	223.6	224.5	232.7
Retail	449.2	464.5	469.2	480.5	487.3	510.8	540.9	531.5	521.4	535.6	526.9	540.6
Total assets	1,025.9	1,069.3	1,082.5	1,108.9	1,133.9	1,176.3	1,255.4	1,239.1	1,226.4	1,258.9	1,251.6	1,294.4
MySuper assets (\$bn)												
Corporate	1.1	9.4	16.3	17.0	17.5	16.1	17.2	17.1	18.0	18.4	18.3	19.2
Industry	116.3	199.6	238.1	244.0	250.2	257.6	272.8	278.8	277.4	284.3	283.9	297.0
Public sector	45.0	73.3	76.4	85.0	87.5	91.6	97.8	97.2	98.0	99.4	100.3	103.9
Retail	0.2	4.9	10.5	16.0	20.0	27.5	32.4	35.4	39.7	47.8	50.1	54.8
Total MySuper assets	162.7	287.2	341.2	362.0	375.2	393.0	420.2	428.4	433.1	449.9	452.7	474.9
Members' benefits in ADAs (\$bn)												
Corporate	14.2	6.1	2.1	2.1	2.0	2.0	2.1	1.9	0.8	0.8	0.8	0.6
Industry	95.8	39.4	10.1	3.4	1.0	1.0	1.0	0.7	0.6	0.6	0.6	0.6
Public sector	28.5	8.1	5.5	0.8	0.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Retail	82.0	75.0	69.5	64.7	64.4	62.0	61.6	55.7	49.6	45.6	41.1	39.1
Total members' benefits in ADAs	220.6	128.5	87.2	71.1	68.3	65.9	65.6	59.2	51.9	47.9	43.4	41.3
Member accounts that include an ADA ('000)												
Corporate	233.3	103.5	34.0	23.6	19.7	18.4	18.1	17.1	8.2	7.9	8.2	5.0
Industry	4,687.7	2,220.4	268.7	27.5	20.5	18.2	17.9	10.3	9.6	9.4	9.3	8.9
Public sector	565.9	174.7	90.1	8.7	8.5	8.5	8.6	8.6	8.4	8.4	8.1	8.0
Retail	4,256.7	3,631.0	3,522.1	3,293.2	3,165.5	3,005.5	2,835.4	2,641.8	2,429.0	2,285.6	2,014.0	1,673.4
Total member accounts that include an ADA	9,743.7	6,129.6	3,914.8	3,353.1	3,214.1	3,050.6	2,880.0	2,677.7	2,455.2	2,311.4	2,039.6	1,695.3
Proportion of total assets in accrued default amounts (%)												
Corporate	22.6%	9.5%	3.4%	3.8%	3.5%	3.7%	3.7%	3.5%	1.5%	1.5%	1.5%	1.2%
Industry	28.5%	11.1%	2.8%	0.9%	0.3%	0.3%	0.2%	0.2%	0.1%	0.1%	0.1%	0.1%
Public sector	16.0%	4.3%	2.9%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%
Retail	18.3%	16.1%	14.8%	13.5%	13.2%	12.1%	11.4%	10.5%	9.5%	8.5%	7.8%	7.2%
All funds	21.5%	12.0%	8.1%	6.4%	6.0%	5.6%	5.2%	4.8%	4.2%	3.8%	3.5%	3.2%
Proportion of ADA and MySuper assets held in ADAs (%)												
Corporate	92.6%	39.5%	11.6%	11.2%	10.2%	10.8%	10.7%	10.0%	4.4%	4.1%	4.2%	3.3%
Industry	45.2%	16.5%	4.1%	1.4%	0.4%	0.4%	0.4%	0.2%	0.2%	0.2%	0.2%	0.2%
Public sector	38.7%	9.9%	6.7%	1.0%	0.9%	1.0%	0.9%	0.9%	0.9%	0.9%	0.9%	0.9%
Retail	99.7%	93.8%	86.9%	80.2%	76.3%	69.3%	65.6%	61.2%	55.5%	48.8%	45.1%	41.7%
Total	57.6%	30.9%	20.4%	16.4%	15.4%	14.4%	13.5%	12.1%	10.7%	9.6%	8.8%	8.0%
Number of RSEs with ADAs												
Corporate	31	26	24	22	20	18	18	16	13	12	12	7
Industry	30	21	14	11	9	8	8	7	5	5	5	5
Public sector	9	8	6	3	3	3	3	3	2	2	2	2
Retail	77	71	62	53	50	50	48	42	42	37	34	32
Total number of RSEs with an ADA	147	126	106	89	82	79	77	68	62	56	53	46

¹ Excluding Eligible Rollover Funds and Approved Deposit Funds as these entities are not able to offer MySuper products.

Paragraphs 11 and 12 of SRS 410.0 specifies the quality control required for data reported on accrued default amounts:

“11. The information provided by an RSE licensee under this Reporting Standard must be the product of systems, procedures and internal controls that have been reviewed and tested by the RSE auditor of the RSE or defined benefit RSE to which the information relates. This will require the RSE auditor to review and test the RSE licensee’s systems, procedures and internal controls designed to enable the RSE licensee to report reliable information to APRA. This review and testing must be done on:

- a) an annual basis or more frequently if necessary to enable the RSE auditor to form an opinion on the reliability and accuracy of information; and*
- b) at least a limited assurance engagement consistent with professional standards and guidance notes issued by the Auditing and Assurance Standards Board as may be amended from time to time, to the extent that they are not inconsistent with the requirements of SPS 310.*
- c) All information provided by an RSE licensee under this Reporting Standard must be subject to systems, processes and controls developed by the RSE*

licensee for the internal review and authorisation of that information. It is the responsibility of the Board and senior management of the RSE licensee to ensure that an appropriate set of policies and procedures for the authorisation of information submitted to APRA is in place.”

APRA-reporting entities submit data to APRA via D2A. APRA uses validation rules within D2A to validate these data. Entities are expected to correct any reporting errors identified by these rules.

In addition to D2A validation rules, APRA also validates data after they are submitted by entities. These post-submission data quality checks identify data inconsistencies that are not highlighted by the D2A validation rules. APRA advises entities of the data identified by these checks outside D2A. Entities are expected to correct (via D2A) or explain data identified by these checks.

Further information on the validation of superannuation data submitted to APRA is available on APRA’s website at:

http://www.apra.gov.au/Super/ReportingFramework/Documents/SA_GL_PED_042010_v2.pdf

Supervisory staff also regularly check data reported on ADAs against the transition plans submitted under SPS 410.

APRA is not aware of any factors which affect the accuracy and currency of ADA transition data.