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13 February 2015

Subject: Superannuation - Select Investment Option Definition

Dear Sir/Madam

The Financial Services Council (FSC) writes in relation to the release by the Australian Prudential Regulation Authority (APRA) of the final definition of Select Investment Options (SIOs) and related reporting forms.

The FSC supports APRA's enhanced prudential and data collection powers in relation to superannuation funds. The growth of funds under management in the system underlies its importance to the Australian economy, as well as individuals' financial wellbeing in retirement. The FSC welcomes the APRA's open and pragmatic approach to consultation and the significant reduction in the number of SIOs captured by the revised definition and the reduction in the frequency of reporting.

Following the APRA SIO announcement on 16 January 2015, however, the FSC and our members have observed technical issues that have arisen through the revised forms (SRF 001.0, SRF 601.0, SRF 533.1 and SRF 702.1). This letter lists these technical issues and raises related questions that are intended to clarify uncertainty arising from the revised reporting standards. It is our hope that by addressing this collectively we may streamline the implementation of the requirements.

In this letter the FSC has also raises an additional policy concern relating to the capture of term deposits, Listed Securities and small Defined Benefit funds within the definition of SIO.

Attached to this letter are 3 Appendices:

- Appendix A: Definitional issues for which it is unclear on how to proceed and the benefits achieved in reporting; we seek APRA's consideration of the application of the SIO definition in these cases;
- Appendix B: Reporting Form Queries for which we would seek responses from APRA; and
- Appendix C: Small drafting issues in the revised forms. We suggest APRA review these and consider rectification before determination of the forms.
- Appendix D: General questions for which we would seek responses from APRA.

Please feel free to contact me on 02 8235 2566 if you have any further questions or comments in relation to this submission.

Yours sincerely

BLAKE BRIGGS
SENIOR POLICY MANAGER

APPENDIX A: APPLICATION OF SIO DEFINITION

The purpose of this appendix is to explore the Select Investment Option definition in the APRA reporting forms SRF 001.0, 533.1, 601.0 and 702.1. In particular to consider if term deposits, listed securities and small Defined Benefit products should be removed from the SIO definition before the final determination of the forms occurs.

Background

In the FSC submission to the APRA Select Investment Option consultation, we suggested the following definition:

> The FSC proposes that the SIO definition be along the following lines:
>
> "A select investment option means an investment option in an RSE which:
>
> a) Where, at the most recent 30 June, the total assets of the RSE exceeds $5 billion:
>
> i) at the most recent 30 June, has assets relating to non-MySuper interests greater than $250 million; or
>
> b) Where, at the most recent 30 June, the total assets of the RSE is less than or equal to $5 billion:
>
> i) at the most recent 30 June, has assets relating to non-MySuper interests greater than $100 million; or
>
> ii) At the most recent 30 June, has assets relating to non-MySuper interests that are less than $100 million but which represent more than 5 per cent of total assets of the RSE within which the investment option is located."
>
> This would also exclude single assets investments, such as term deposits or listed securities.

Following the consultation process in 2014, the SIO definition has recently been modified by APRA to be:

> ***select investment option*** means an investment option within an RSE:
>
> (a) to which a member of that RSE may select to have all or a part of their interest directed, and that at the most recent 30 June has assets relating to non-MySuper interests which represent:
>
> (i) more than five per cent of total assets of the RSE within which the investment option is located; or
>
> (ii) less than five per cent of total assets of the RSE within which the investment option is located, but that are greater than $200 million; or
>
> (b) which underlies:
>
> (i) a defined benefit pension within the meaning of SPS 160, where that defined benefit pension is currently being paid; or
>
> (ii) an interest that entitles the member who holds the interest, when benefits in respect of the interest become payable, to be paid a benefit referred to in the definition of 'defined benefit member' in SPS 160;

FSC members have indicated that it is unclear on how to report SIOs across their term deposit, listed securities and Defined Benefit products and that it will be challenging to do so on a cost effective basis. These are explored below with suggested changes noted at the end of each section.

A.1 Defined Benefits

The FSC suggests that APRA reconsider the need for Defined Benefits to be included in the SIO definition if they are below a $50 million threshold (leg B).

Rationale

- There is nothing to link data for a defined benefit interest to the actual interest in an RSE which caters for numerous individually funded defined benefits in sub-plans of a corporate superannuation master trust. We believe that defined benefit data provided in other SRFs such as 330 and 160 should provide sufficient information to allow APRA to properly supervise these arrangements.

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- Large investment funds (proportionate to the size of the RSE) underlying DB interests will already be picked up in leg A of the definition.
- Where an investment fund which underlies a DB member interest is smaller, then the cost of such reporting becomes non-commercial. Our membership has provided example situations:
  - 3 DB related investment options that are above the $200m threshold and reported under leg A. This will result in 3 x 4 = 12 SIO reports annually in SRF 533.1 (no additional reports for SRF 702.1 and just 3 extra lines in SRF 001.0 and SRF 601.1)
  - 40 DB related investment options that are below the $200m threshold and reported under leg B. This adds 40 x 4 = 160 additional SIO reports annually in SRF 533.1 (no additional reports for SRF 702.1 and just 3 extra lines in SRF 001.0 and SRF 601.1)
  - While some of these smaller 40 DB related investment options might be close to the threshold (e.g. over $175m), the smallest might be just $15K. Therefore, it is not cost effective for the membership to pay a large provider to produce specific reporting to APRA on an investment option that is only worth $15K of Defined Benefit Interest.

From the above, we are not certain that the RSE licensee cost in complying with the revised reporting is proportionate to the risk and small membership involved in these investments and it is not clear that the reports produced would add any regulatory oversight benefit.

Recommendation: remove the Defined Benefit leg from the definition of a Select Investment Option and rely upon the following definition as the sole test of an SIO:

select investment option means an investment option within an RSE:

that at the most recent 30 June has assets relating to non-MySuper interests which represent:

(i) more than five per cent of total assets of the RSE within which the investment option is located; or

(ii) less than five per cent of total assets of the RSE within which the investment option is located, but that are greater than $200 million;

A.2 Term Deposits

The FSC members are having trouble with the application of the SIO definition and investment option definition to term deposits (TDs). Primarily it is not clear if TDs were intended to be captured, and we would appreciate clarification on this point.

The FSC recommends that APRA remove term deposits from the investment options definition but if APRA does not agree with this recommendation then we ask that APRA help clarify how RSE licensees should report TDs.

Rationale

- WRAP Platforms and large superannuation providers often offer term deposits which vary by rate duration and term deposit provider.
- By definition in SRF 001.0, "*If an investment option is offered through multiple product channels or with multiple fee structures, with no change to the underlying investment strategy, apply the principles outlined within Attachment B to determine how many times the investment option is to be classified as a select investment option and therefore reported to APRA*". It appears that as the underlying investment strategy of a 2 year term deposit is different to the underlying investment strategy of a 30 day term deposit, they are different investment options.
- By the same definition in SRF 001.0, it appears that the underlying investment strategy of a 3 year term deposit issued 2 years ago with an interest rate of 5% has a different underlying investment strategy to a 3 year term deposit rate issued today for 3%. So these are different investment options.
- By definition in SRF 601.0, "*For the purposes of this Reporting Standard, an 'investment option' includes but is not limited to pre-mixed options, investment vehicles and instruments that are*

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made available, or have previously been made available, by the RSE licensee from which members of an RSE can select when determining how their interest is to be invested". It appears from this definition that as the RSE may offer a range of TDs from "BANK A" and a comparative range of TDs from "BANK B" on their product from which a member can choose each of these bank's TD's are different investment options.

- Therefore, it appears that we should regard each term deposit issued (i.e., unique rate, duration, provider) as a separate investment option for the purpose of assessing whether it is an SIO.
  - Example: pre-existing "BANK A" 2 year TD maturing Feb 2015 (therefore issued 2013) will have a different rate to a "BANK A" 30 day TD rate maturing March 2015 (issued 2015).
  - Example: new "BANK A" 2 year TD rate maturing Feb 2017 will have a different rate to a pre-existing "BANK A" 2 year TD rate maturing March 2015.
  - Example: new "BANK A" 2 year TD rate maturing Feb 2017 will have a different rate to a new "BANK B" 2 year TD rate maturing Feb 2017.
- If we **do** consider each unique TD combination (provider, rate, duration) as an investment option, then clearly few if any TDs will pass the SIO test. However the resulting impact is that in SRF 601.0 item 6.1 the RSE will need to "*Report the total number of investment options offered in the RSE in item 6.1, i.e. the total number of investment options including select investment options*". Therefore each unique combination of provider, rate, and duration will add an "investment option" to the tally. If the RSE offers "BANK A" TDs of: 30, 60, 90 day and 6 mth, 1 yr, 3 yr then that is 6 investment options. If the rates then change, 6 more investment options are added to item 6.1. If the rates then change again, 6 more investment options are added to item 6.1. It will therefore become increasingly difficult to determine the number of unique investment options within an RSE.
  (Note: one provider estimates this will add thousands of investment options to their count in item 6.1 but no additional SIOs).
- If we **<u>do not</u>** consider each unique TD combination (provider, rate, duration) as an investment option, then the number of investment options in item 6.1 of SRF 601.1 decreases but then the investment returns reported in SRF 702.1 will not make sense:
  - the investment return on a 30 day term deposit is different to the investment return on a 3 year term deposit.
  - the investment return on a 3 year term deposit issued 2.5 years ago is different to the investment return on a 3 year term deposit issued today.

It is therefore not clear how to report the return for these TDs on SRF 702.1.

Recommendation: remove t<u>erm deposits</u> from the definition of an investment option (in all forms) and therefore from the consideration of SRF 601.1 item 6.1 and from returns in SRF 702.1. This can be done as as per the following definitional change:

For the purposes of this Reporting Standard, an 'investment option' includes but is not limited to pre-mixed options, investment vehicles and instruments that are made available, or have previously been made available, by the RSE licensee from which members of an RSE can select when determining how their interest is to be invested. <u>However, this excludes term deposits and listed securities.</u>

A.3 Government Bonds

The FSC members are having trouble with the application of the SIO definition and investment option definition to government bonds. The issues are largely the same as term deposits (TDs) because different government bonds may have different yields and maturity dates. APRA should clarify how RSE licensees should report these.

A.4 Listed Securities

The FSC members are having trouble with the application of the SIO definition and investment option definition to Listed Securities. It is also not clear if listed securities are captured and we would appreciate further clarification.

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The FSC recommends that APRA remove Listed Securities from the investment options definition but if APRA does not agree with this recommendation then we would appreciate further clarification on how RSE licensees should report these.

Rationale

- Largely, the issues are not too dissimilar to term deposits.
- WRAP Platforms and large superannuation providers often offer ASX listed securities which may include companies, listed interest rate securities, ETFs, options etc.
- Except for very large ASX companies, it is unlikely that ASX companies will meet the SIO definition within an RSE's offering. However, if we take the largest holding – it is likely to be BHP. But there are 113 ASX codes that begin with BHP. Mostly these are warrants/options and they would have a distinct and different "*underlying investment strategy*" compared to BHP (the company). Clearly, the investment return (as reported in SRF 702.1) would be entirely different.
- Therefore, it is expected that we should regard each direct security (i.e., unique ASX code) as an investment option for the purpose of assessing whether it is an SIO.
- If we **do** consider each unique ASX code (company, warrant/option) as an investment option, the resulting impact is that in SRF 601.0 item 6.1 the RSE will need to "*Report the total number of investment options offered in the RSE in item 6.1, i.e., the total number of investment options including select investment options*". Therefore each unique combination of BHP ASX code (all 113 BHP warrants/options) could add an "investment option" to the 6.1 tally in SRF 601.0.
- It is problematic for platforms that offer ASX trading to accurately count the number of investment options **offered** for item 6.1 in SRF 601.0:
  - There are currently 2,176 companies on the ASX "Listed Companies Register". Regardless if any member holds them, each would need to be included in the count for item 6.1 if the membership can theoretically choose them.
  - The ASX "Listed Companies Register" list is updated at approx. 12am (midnight) after each trading day. Therefore the list would need to be downloaded on the last day of an APRA reporting period (thus it is very time sensitive).
  - The companies list does not include warrants/options (e.g. BHP's 113 items only count as 1 item "BHP" in the ASX "Listed Companies Register"). Therefore if it is at all possible to accurately count the number of ASX investment options **offered** for item 6.1 in SRF 601.0 it could be in the order of 10,000.
- If we **do not** consider each unique ASX code (company, warrant/option) as an investment option, then the number of investment options in item 6.1 of SRF 601.1 decreases but then the investment returns reported in SRF 702.1 will not make any sense
  - the investment return on a BHP company share is different to the investment return on a BHP warrant / option.
  - the investment return on one BHP warrant / option is different to the investment return on another BHP warrant / option.

  It is therefore not clear how to report the return in SRF 702.1 for the few securities that meet the SIO definition

Recommendation: remove listed securities from the definition of an investment option (in all forms) and therefore from the consideration of SRF 601.1 item 6.1 and from returns in SRF 702.1. This can be done as per the following definitional change:

For the purposes of this Reporting Standard, an 'investment option' includes but is not limited to pre-mixed options, investment vehicles and instruments that are made available, or have previously been made available, by the RSE licensee from which members of an RSE can select when determining how their interest is to be invested. However, this excludes term deposits and listed securities.

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APPENDIX B – Specific Queries on Specific forms
(NOTE: REFER ALSO TO ITEMS ALREADY RAISED IN APPENDIX A)

SRF 001.0

B.1 Investment Options – Pension/ Accumulation and "no change to the underlying investment strategy". The form identifies a single investment option as independent of product channels or multiple fee structures but has "no change to the underlying investment strategy". It outlines that a select investment option can have member interests in both the accumulation and pension phase. Further advice is requested as to what constitutes an "underlying investment strategy". Is it where there is a single Strategic Asset Allocation, including benchmarks and ranges which has a single manager?

B.2 The diagram in Attachment C only works/applies at 30 June each year. This is somewhat consistent with the footnote to the SIO definition in all forms that links the point in time for application of part (a) of the SIO definition to 30 June each year. However, the instructions in Part E seem to suggest the assessment of an SIO under (b) of the definition is to occur continuously throughout the year and ad-hoc changes (to past details reported in Part E) are to be reported within 28 days. In addition, Para 7 is missing the ad-hoc reporting for SIOs covered in Part E. The timing of application of the definition requires clarification.

B.3 Wording in Part C (paragraph 3) refers to submission of SRF 001.0 where "the RSE…..ceases to operate…" We note that paragraph 4 of the Part E, Instructions also requires 'ad hoc' reporting if the RSE ceases to operate. We question this reporting requirement for Part C and Part E, noting the requirements of SRF 602.0 Wind Up. Alternatively, for Part E should this refer to "defined benefit RSE" or should it be deleted?

B.4 Item 7 SRF 001.0 Instructions, states:

"For a new select investment option the effective date is the date on which the select investment option is made available to members."

Does the same effective date apply to all SIOs reported in the SRF 001.0 lodged in July 2015? APRA Reporting FAQ 12 states that if the effective date is not known, APRA expects the earlier of the date that the first PDS was issued or the date the APIR code was obtained. Please clarify the requirement.

B.5 We assume that all SIOs reported in the SRF 001.0 lodged in July 2015 should be reported as 'Existing' rather than 'New' in item 7. Please clarify.

B.6 We have previously reported on the number of SIOs on SRF 601.0. The revised SIO definition now means that the number of SIOs will be different. The identifier details required in item 7 will therefore differ from what we have previously reported. APRA should clarify how we now should proceed with completion of this item

SRF 601.0

B.7 In previous submissions of SRF 601.0 we have used an Identifier (item 6.2.1) for an investment option that was deemed an SIO under the previous definition. Is this previous identifier still relevant?

B.8 Should Item 6.2, column 3 'Member's Benefits' being the "sum of defined contribution member's benefits and defined benefit member's benefits" equal to the Item 5.1 (Defined contribution member's benefits) and Item 5.2 (Defined benefit member's benefits) on SRS 320.1 for the annual 30 June submission? There is no mention of a validation check required between these two forms.

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SRF 702.1

B.9 For 702.0 (MySuper), we derive investment and administration fees by apportioning actual fee revenue against average assets each quarter. The instructions and examples in 702.1 utilise the High and Low fee scales rather than deriving fees. Although elsewhere in the instructions there are references to reporting based on "transactions that occurred during the reporting period", it seems that the fees and costs in 702.1 are simply sourced from the pre-determined fee scales in operation. The examples and comments in the section "Comparison to Product Disclosure Statement requirement" seem to support this interpretation. We wish APRA to clarify this internal confusion within the instructions and examples.

B.10 It is not clear how often the assessment of "Highest Scale" and "Lowest Scale" fees in operation within an SIO needs to be assessed. Are these set at the beginning of the reporting period and reported against this going forward or reset each quarter? Are they based on the 'actual' highest and lowest fees members are paying during the period? If set up front then are they apportioned/time adjusted going forward?

B.11 If the 'High' and 'Low' fee scales change between quarters, the High and Low investment performance outcomes 'bookends' will change meaning that quarter to quarter performance ranges are not comparable. Is this what APRA expects?

B.12 The 'scale' must take into account the lowest level of fee rebate. It is not clear what is meant by "…which in some cases may be nil."

B.13 There are conflicting messages and instructions in the Standard and APRA's "Response to Submissions" regarding the use of 'hard close' and 'soft close' data:

- In APRA Response to Submissions: Reporting standards for select investment options, issued 16 January 2015, APRA commented:

  > "As it is possible that RSE licensees will use soft close data for the purposes of quarterly reporting, it may be that hard close year-end information results in material differences to the data reported to APRA throughout the year. In this instance, APRA expects that RSE licensees would re-submit the relevant data to ensure the accuracy of the information provided to APRA for prudential supervision and publication purposes." (p.10)

  This suggests that quarterly form submissions made "throughout the year" may need to be re-submitted. Please confirm that this is not the case and that only the 30 June quarterly submission may be subject to re-submission.

- Instructions (page 1) require that items be reported on 'hard close' prices, yet p.10 of "Response to Submissions" seems to allow RSELs to use 'soft close' prices. If 'hard close' prices are required for investment return calculations, this would be inconsistent with current industry standards and practices, where investment performance calculations are based on soft close data due to dependency on being able to source and process the data in a timely fashion. Whilst we may have easy access to 'hard close' prices for investment options managed by a related party, that information would only be available late in the 28/35 day reporting window. Some investment managers do not provide 'hard close' data. APRA should amend the reporting to confirm the statements made in the "Response to Submissions" document.

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APPENDIX C – Small Drafting Issues on Specific forms

(NOTE: REFER ALSO TO ITEMS ALREADY RAISED IN APPENDICES A AND B)

SRF 001.0

C.1 The footnote 4 on SRS 001.0 – page 4 and footnote 2 on SRS 001.0 Instructions – page 9 includes as a final sentence: "*Refer to Reporting Standard SRS 001.0 Profile and Structure (Baseline) for obligations to report information about investment options and select investment options to APRA on 30 June each year*.". The reference seems unnecessary in this SRS. The cross-reference to SRS 001.0 is confusing. However, we note it is relevant in the footnotes to the SIO definition for SRSs 533.1, 601.0 and 702.1.

C.2. The 3rd bullet point on page 8 (under instructions for Item 7) makes an erroneous reference to "column 8" which does not exist. In any case, we believe that the words "*otherwise, leave column 8(7) blank*" are superfluous and should be removed.

C.3 Attachment C – the first bullet point in the right hand box could be read such that it does not deliver a "Limb A" outcome. We suggest that the bullet point be reworded as follows:

- *the accumulation balance of one or more members, where "accumulation balance" includes balances of members with accumulation interests only and also accumulation balances of members who also hold defined benefit interests; or*

SRF 601.0

C.4. Item 6.2.5 – The number of options flagged as Yes will not reconcile to the number of options flagged as Limb B in SRF 001.0 due to options being both Limb A and B being regarded as Limb A in 001.0. We suggest that the second last paragraph in the instructions for Item 6 be amended to: "If the select investment option is used to back defined benefit interests and classified as Limb B in SRF 001.0, report 'yes'…".

C.5 There is a typographical error in the last paragraph of the item 6 instructions. The reference to "column 5" should be a reference to "column 6".

SRF 702.1

C.6 The 1st Table of the example on page 2 is confusing as it has split the scale "Advice fee" into "Activity fee" A and "Activity fee" B. The definition of "advice fee" in s29V(8), SIS Act, is different to the definition of "activity fee" in s29V(7).

C.6 The instructions of 702.1 for item 3 (Advice fees) are inconsistent with 702.0 as they do not exclude 'per activity' fees. The intent of 702.1 should only to report fees that are collectively charged.

C.7. Items 3.4 and 13.4 are labelled "Example member advice fees" rather than "Example member advice fees and costs"

C.8 We have compared the instructions of 702.1 with those of 702.0. The instructions of 702.1 for item 3 (Advice fees) are inconsistent with 702.0 as they do not exclude 'per activity' fees. We believe the following paragraph that appears in 702.0 should be added to the instructions for items 3, 4, 13 and 14 in 702.1 (appropriately worded for each data item):

> Only report collectively charged advice fees, indirect cost ratio advice costs and other advice costs in item 3. Where members are charged individually on a 'per activity' basis for advice - related matters, these are not collectively charged amounts and must not be included in item 3.

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Appendix D: General Questions

The FSC would appreciate consideration of the following issues to assist with general implementation:

D.1. Lodgement: In July of 2015 RSEs will have new annual forms, new quarterly forms, and commenced analysis of ABS reporting. In addition, going forward the heavy burden of SIO reporting will add about 100 forms per large RSE. To reduce the reporting due dates for any reports will put considerable strain on our reporting teams, and will prove difficult with current timing on the delivery of dependant data. Would it be possible for APRA to consider that all quarterly reports should remain due 35 days and annuals 4 months after the end of the reporting period for the foreseeable future until volumes and processes stabilise.

D.2. A number of challenges exist on reporting SIOs for options within Platforms, primarily related to the usage of the working cash account and related member flows and subsequent treatment of fees and taxes.

Fees and flows for the whole entity are recorded against the working cash account.

- the main issue in wrap accounts is that member's money flows thru the cash account to get to the individual investment – and therefore EVERY investment's flows (including stock dividends) will pass thru the cash account which will make the cash account movement reporting in SRF 533.1 completely non-sensical. Member example assuming 15% contributions tax and $50 annual administration fee:
  - $1000 contribution into super wrap will first go into the cash account
  - $150 deducted for contributions tax will come out of the cash account
  - $850 will then come out of the cash account (almost immediately) and will be invested into, lets say, 4 investment options and BHP stock
  - When BHP declares a dividend, that money will get paid to the cash account.
  - When the member decides to switch funds between managed investments, the sell will result in money moving into the cash account and then the next managed investment.
  - Once a year the cash account will have the annual fee deducted from it.

  Clearly the cash account has had multiple "ins" and "outs" to be reported. But in fact these are not all true "member flows" where members have selected the "cash account" – in many cases it is a transitory account between investments. Reporting in 533.1 items 4, 5 and 6 is therefore problematic for cash accounts in wrap platforms. Guidance from APRA is sought.
- Fees for members are charged for the overall holdings including cash and other options, however there may not be a specific fee recorded against the individual option. Does APRA recognise this?
- The cash account may occasionally have assets over 5% or $200m and may be classed as an SIO. Is that what APRA intended? The impact will be that performance returns in SRF 702.1 will be wildly overstated because the member fees affect just the cash account.
- The investment options record the acquisition and disposal of the investments but do not match the capital flows of members because many platforms aggregate the member flows with other income and expense transaction before an investment disposal and acquisition occurs.
- Because members may hold many investments in their Wrap account; performance for an individual option is traditionally calculated at the MIS level and may not include member fees charged by the Super Fund. Calculation of SRF 702.1 performance for an example member will therefore overstate fees on any single investment (as mentioned above) and will require a new performance calculation considering distributions, fees and taxes; and this new figure will not be used in member communication or general publication of investment returns because it would be misleading. We seek to confirm that APRA recognises this issue.

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