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Director
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Dear Sir/Madam,

Your Future, Your Super Draft Regulations

AMP appreciates the opportunity to make a submission in relation to the Your Future, Your Super (YFYS) Exposure Draft Regulations and Explanatory Material released on 28 April 2021.

We have concerns with several elements of the YFYS Exposure Draft Regulations and have contributed to both the FSC and ASFA submissions in relation to these concerns.

However, there are two concerns that we wish to highlight in relation to the product performance assessment:

- the inclusion of historical administration fees, and
- the absence of adequate APRA discretion to manage historical anomalies.

Historical administration fees

These reforms represent a fundamental change to the superannuation system.

It is critical for the government to ensure the methodology proposed will achieve the policy objective '*to protect members from poor outcomes and encourage funds to lower costs.*'[1]

We do not consider that this is presently the case as there are significant problems with the completeness and accuracy of the historical administration fee data.

Any assessment using historical administration fee data will be a poor measure of the actual experience of individual members.

Reliance on historical administration fee data will lead to materially inconsistent outcomes for virtually identical products and can lead members to make decisions to their detriment.

[1] Senator The Hon Jane Hume and The Hon Josh Frydenberg MP, *Your future, your super - making your super work harder for you*, Joint media release, 6 October 2020 (https://ministers.treasury.gov.au).

This was recognised in the *Productivity Commission Report - Superannuation: Assessing Efficiency and Competitiveness* (PC Report) which stated:

> *'despite regulator awareness, there remain significant gaps and inconsistencies in how funds report data on fees and costs … this harms members by making fee comparability and decision making difficult at best and renders fee based competition elusive'*.'[2]

The historical administration fee data proposed to be used for the performance test is unreliable and will not support comparison of products on a like for like basis due to:

- incompleteness of the data held by APRA,
- inaccuracies in the data, and
- diluting the impact of recent fee changes.

Reconstruction of historical administration fee data held by APRA to establish complete and accurate data over an eight-year lookback period would be extremely difficult, if not impossible, to achieve based on the data currently held by super funds. Accurate records may not be available for data not previously required to be reported to APRA.

a) <u>Incomplete data held by APRA</u>

Use of reserves to fund administration costs

Existing APRA reporting standards do not require funds to include amounts transferred from reserves (to cover administration costs) in the administration fee reported.

This means that in certain circumstances *historical* administration fees reported for products that use reserves to pay administration fees will be understated compared to fees reported for products that do not use reserves (and have reported the full value of the administration fee to APRA).

This means that with the same investment performance and actual administration fee, products can have materially different performance assessment outcomes, simply because of the use of reserves.

Issues arising as a result of incomplete data held by APRA due to the use of reserves by some funds to utilise tax credits for administration costs to allow a lower administration fee to be charged (and reported) are resolved by the inclusion of administration related tax expenses in the performance measure.

An issue arises, however, in relation to the treatment of tax credits in relation to insurance premiums.

Some products hold these tax credits in reserves used to fund administration fees. Because amounts transferred from reserves are not currently reportable, this has resulted in lower administration fee values being reported to APRA for these products.

Other products pass the benefit of tax credits directly back to those members of the product who have paid for insurance. This benefit to members is not reflected in the *historical* administration fee data held by APRA.

Chant West indicates in its submission to the YFYS Exposure Draft Regulations that at least 13 super funds have reported lower administration costs to APRA due to the use of reserves during the proposed eight-year lookback period. Chant West estimates that administration fees for these funds are understated by a median 'of 7 basis points in 2020 and 14 basis points in 2015'.[3]

Reliance on incomplete historical data held by APRA will artificially lower the benchmark and could be the difference between a product passing or failing the performance test.

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[2] Productivity Commission Report - *Superannuation: Assessing Efficiency and Competitiveness*, Finding 3.6, page 184.
[3] Chant West, *Submission to YFYS Consultation*, May 2021.

APRA data standards proposed to underpin the product performance assessment align to fee disclosure rules set out in ASIC RG 97. Revised RG 97 requirements designed to improve comparability of fees and costs between super funds will address this issue by requiring trustees to disclose administration costs paid from reserves. Full compliance with revised RG 97 requirements is not, however, required until September 2022 and will not resolve deficiencies in historical data.

Administration fee discounts not considered

It is common for employers to agree a discounted administration fee to apply to their employees who hold the MySuper product.[4] In our experience, these types of arrangements could result in an increase to the actual net return experienced by members of up to 0.5% (or $2,300) over eight years based on a $50,000 balance.

For the AMP MySuper product, excluding average administration fee discounts is estimated to result in the performance test result being overstated by nine basis points.

The historical administration fee data to be used for the performance assessment does not capture these administration fee discounts. As a result, the proposed performance assessment will understate the actual performance experienced for many MySuper members.

This could result in members being advised that their MySuper product is underperforming when, for them, that is not correct.

These members may be misled to transfer to another product and unknowingly give up valuable insurance benefits and financial support provided by their employer (e.g., subsidies of costs or insurance premiums or additional contributions).

Administration costs for insurance not considered

Under the MySuper fee charging rules,[5] Insurance fees can include both insurance premiums and costs of the trustee to administer insurance.

Some products charge the cost of administering insurance as part of the 'Insurance Fee'. Other products include it in the 'Administration Fee'.

Insurance Fees are not included in the performance assessment.

This means that with the same investment performance and actual administration costs, products can have different performance assessment outcomes, depending on whether the trustee has included the cost of insurance administration in the 'administration fee' or the 'insurance fee'.

b) Inaccurate data reported to APRA

Chant West analysis indicates that at least 13 funds have failed to report administration fee data to APRA over the proposed lookback period.[6]

Using the historical administration fee data as proposed, without resolving these inaccuracies in data, means the performance test results for these funds will be understated.

This missing data will also artificially lower the benchmark which could be the difference between a product passing or failing the performance test.

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[4] MySuper fee charging rules in the *Superannuation Industry (Supervision) Act 1993* (SIS) generally require that all MySuper members are charged the same dollar or percentage based fee however section 29VB allows an employer sponsor to agree a discount to the administration fee to apply to its employee members who hold the MySuper product.

[5] Section 29V(9) of SIS

[6] Chant West, *Submission to YFYS Consultation*, May 2021.

c) <u>*Diluting the impact of recent fee changes*</u>

Masking underperformance prior to PYS reforms

Before the introduction of 'Protecting Your Super' (**PYS**) reforms requiring inactive low balance accounts to be transferred to the ATO, some products had a large number of inactive low balance accounts. This allowed those products to charge a low flat dollar administration fee because the administration cost was spread across that large number of small accounts.

After transferring those inactive low balance accounts to the ATO in 2019, many of those products/funds increased administration fees (because the same total administration cost is now spread across fewer accounts meaning an increased administration fee for each account).

That increased administration fee reflects the real ongoing experience of members in that product.

Using historical administration fees in the performance assessment, will significantly dilute that real administration cost. This will mask underperformance and will not reflect the member's current and likely future experience in that product.

Historical data does not reflect current member outcomes

Administration fees have fallen sharply for super products over the past eight years and accordingly historical administration fees are not an accurate measure of the current or likely future member experience.

As Chant West noted in its submission, 'historical fees are not what is most relevant to current members of the fund, many of whom have only joined the fund in the last 1-3 years.'[7]

Recent fee reductions as well as increases will be significantly diluted over an eight-year lookback period. Chant West analysis indicates that since June 2017, 24 funds have increased administration fees and 32 funds have decreased fees, with many retail funds decreasing fees by 20-30 basis points in 2020.[8]

Whether a member is now in a well-performing product, should be determined by the current administration fees (*consistent with fee rankings the YourSuper comparison tool will display*).

<u>**Need for adequate APRA discretion**</u>

The key policy objective of the YFYS is to ensure that underperforming products and funds are held to account but to permit those products/funds that will perform well in the future to continue.

A mechanistic process such as the YFYS policy is unlikely to give this outcome. Some good funds are likely to fail and some poor performing funds are likely to pass.

For this reason, AMP considers that APRA should have a limited discretion to intervene in these circumstances.

Examples include:

- Where the lookback period might be inappropriate. For example, if an 11-year lookback period were to be applied to some funds they might pass the test over this longer period[9]
- Where funds have merged during the eight-year lookback period and they have complex histories
- Where APRA considers that the data may be inadequate, or mis recorded
- Where there have been substantial fee discounts

AMP considers that under all these circumstances, APRA should have a limited power of discretion.

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[7] Chant West, *Submission to YFYS Consultation*, May 2021.
[8] Chant West, *Submission to YFYS Consultation*, May 2021.
[9] Productivity Commission Report - *Superannuation: Assessing Efficiency and Competitiveness*, page 146.

APRA has deep specialist expertise and experience in the superannuation industry. As such all of its discretions in relation to YFYS should be exercisable without the need for consultation with Treasury.

Summary

AMP considers that to improve the integrity and comparability of the administration fee data underpinning the performance assessment and better align assessment outcomes with current and likely future member outcomes:

- Commencement of the performance assessment should be deferred by 12 months to provide APRA sufficient time to audit the data quality and collect missing and incomplete data,
- Regulations should be modified to ensure administration fee data used for the performance assessment takes into account administration costs paid from reserves and average fee discounts,
- The methodology for the product performance assessment should measure administration fees based on data for the most recent financial year, rather than an eight-year lookback, and
- APRA should have a power of discretion to intervene in limited circumstances.

Should you have any queries, or wish to discuss further, please contact me on 0412 437 315.

Yours sincerely

Alastair Kinloch