

## AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

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APRA

**WAYNE BYRES**

Chairman

5 February 2018

The Honourable Kenneth Hayne AC QC  
Commissioner  
Royal Commission into Misconduct in the Banking,  
Superannuation and Financial Services Industry

Dear Mr Hayne,

I refer to your letter of 15 December 2017 that sought information that would be of assistance to you in your conduct of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (the Royal Commission). As requested, APRA provided an initial response on 15 January 2018. This letter provides APRA's further response.

This letter also responds to the Commission's letter of 23 January 2018, and related discussions with Solicitors Assisting the Commission, arising from our 15 January response.

**Requested information**

The Commission's letter of 15 December requested that APRA provide information regarding APRA's identification of "misconduct", as defined in the Commission's terms of reference, by financial services entities since 1 January 2008, and the steps that APRA has taken in response. The letter requested an overview by 15 January and our complete response, including any supporting documents by 5 February.

Appendix A to APRA's 15 January letter provided a list of cases that evidence instances of poor governance, culture and fitness and propriety that fall explicitly within APRA's prudential mandate and where APRA has taken formal or administrative action to ensure they are appropriately addressed. We undertook in the 15 January letter to provide further information on these cases. The **Index to Appendix A** provides a schedule of the supporting documents, which are also provided with this letter. The Index includes the identification of documents which we seek be kept confidential and the bases on which the claims for are made.

Appendix B to APRA's 15 January letter provided a list of cases which contain an element of behaviour that might be broadly considered to relate to 'misconduct' and where appropriate outcomes in response to the matter were achieved through various supervisory measures (rather than formal or administrative action by APRA).

The Commission's letter of 23 January 2018 (paragraphs 2(a)-(h)) requested additional information on a number of these cases. **Appendix B1** and the **Index to Appendix B1** attached to this letter provides this additional material.

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### APRA's consultations with RSE Licensees

The Commission's letter of 23 January (paragraphs 3-4) requested additional information regarding APRA's engagement with RSE Licensees on strengthening Superannuation Member Outcomes:

- ***Paragraph 3: On page 7 of your letter you refer to APRA's consultation with RSE licensees in respect of proposed changes set out in APRA's Discussion Paper entitled "Strengthening Superannuation Member Outcomes". I would be grateful if you could please provide the Commission with copies of any responses received from RSEs in response to that paper once received (or direct the Commission to any publication of the same on the APRA website).***

The consultation period on the "Strengthening Superannuation Member Outcomes" package closes on 29 March 2018. APRA is yet to receive any submissions in response to the consultation package.

APRA's policy is to publish all submissions on the APRA website unless a respondent expressly informs APRA in writing that all or part of the submission is to remain in confidence. Where respondents would like only part of their submission to remain in confidence, they are requested to provide this information marked as 'confidential' in a separate attachment.

APRA will make available the submissions to the Commission. However, we expect the content of these submissions will be focused on the entity's response to the proposed policy reforms rather than containing detailed information about specific entity practices that might be more relevant to the Commission.

Where APRA receives submissions marked as 'confidential', APRA's proposed course will be to indicate to the Commission that the submission has been received and that a claim of confidentiality is made. As a matter of natural justice, APRA will also notify the submitter of the request from the Commission for production of the submission to the Commission, and their right to object to production, before making the confidential material available to the Commission.

- ***Paragraph 4. Further, I note that in APRA's letter to RSE Licensees dated 31 August 2017 entitled "Assessing Member Outcomes in the Superannuation Industry", APRA referred to certain metrics used to assess historical outcomes and future sustainability of RSE Licensees, including "administration and operating expenses as a percentage of average net assets (operating cost ratio)". I would be grateful if you could provide the Commission with such data for the years 2010 onwards (where available) in an electronic format that is machine-readable (or direct the Commission to any publication of the same on the APRA website). Please also identify for the Commission any RSE Licensees which APRA has identified in this time as having unusually high operating cost ratios.***

The requested information - *administration and operating expenses as a percentage of average net assets (operating cost ratio)* - is provided at **Appendix C**. The following commentary and context is also provided.

The information provided at **Appendix C** includes information for the period from June 2004 to June 2016. However APRA's information collection and reporting framework for APRA-regulated superannuation funds was significantly updated in 2012-2013, resulting in the collection of more granular data about RSE licensee business operations, including data related to fund financial statements. Because the reporting requirements changed

significantly in 2013, it is not meaningful to compare the data reported for the period through to 2013 with the data reported for June 2014 onward.

Whilst the quality of this data continues to improve, APRA has identified a number of weaknesses in the way that RSE licensees are reporting to APRA about fund expenditure. One key weakness in the data is the inconsistent categorisation of investment, administration and operating expenses because of the reliance of the reporting requirements on the Australian Accounting Standards, which permits RSE licensees significant discretion when deciding how to classify their fund expenses. This reduces how readily the operations of different funds can be compared. APRA's current reporting proposals (as outlined in the Strengthening Superannuation Member Outcomes package) are designed to remedy this weakness and put in place requirements that result in more comparable data.

APRA, in its ongoing communications with RSE licensees, continues to emphasise that assessing outcomes must involve more than just consideration of a single performance measure or metric – for example, RSE licensees must be looking beyond just the net return delivered or the fees and costs charged to members to understand the drivers behind the outcomes being delivered. This applies similarly to forward-looking metrics related to sustainability, including metrics relating to fund expenditure. Where the data shows unusually high operating costs, APRA will explore with the relevant RSE licensee the root cause of this level of expenditure, including whether there is a justifiable explanation for costs being as they are.

As outlined in APRA's 31 August 2017 letter to RSE Licensees, APRA has used reported data to assess all RSE licensees with a view to identifying those RSEs which, in APRA's view, appear on this metric not to have consistently delivered quality member outcomes in the recent past, and so may be unlikely to deliver quality member outcomes in the future and/or may not be sustainable into the future. This assessment considers historical outcomes and key indicators for future sustainability. The operating cost ratio falls into the latter category. As APRA now has three years' worth of data from RSE licensees, it is now possible to undertake meaningful trend analyses as part of this assessment.

Whilst APRA does consider performance against each of these metrics used in the assessment on an absolute basis, the list of funds that have been identified as failing to consistently deliver sound outcomes has been generated on a relative basis (the outlier list), using the RSE or product ranking for each metric and to identify RSEs that are in the bottom quartile on a specific measure.

It is important to note that APRA's letter of 31 August outlined how APRA will use this information as part of its supervision. This will include RSE licensees having an opportunity to further engage with APRA regarding the data or any associated action plans. For instance, a number of RSE licensees on the list at **Appendix C** have already indicated a plan to exit the industry or restructure the funds. Further, a number of the RSEs listed are employer-sponsored defined benefit funds which are more expensive to operate, but where expenses are borne by the employer sponsor rather than the member, so member outcomes are not adversely affected.

The data provided in **Appendix C** includes data that is published or is derived from published data. This data is not protected information within the operation of s.56 of the APRA Act. However the decision to include a particular RSE on the outlier list is the result not only of analysis of the published and derived data, but also of consideration of protected information and APRA's supervisory judgement. As such APRA requests that the names of the funds and RSE licensee included in the table in **Appendix C** be treated as confidential by the Commission on the basis that the names are the product, at least in part, of an analysis of protected information.

## Other information requested

The Commission's letter of 23 January (Paragraph 5) indicated that further information in relation to individual cases or complaints where the actual or likely impact on beneficiary outcomes was immaterial, where the information or complaint was insufficient to warrant taking action, or where the misconduct did not raise prudential concerns may be useful to the Commission.

We have provided in **Appendix D** an illustrative list of matters falling into this category. We would be happy to discuss further the types of matters shown.

In relation to this request, and also relevant to a number of matters shown in **Appendix B1**, the following information regarding enquiries and complaints received by APRA may also be useful to the Commission.

## Enquiries and complaints received by APRA

As noted in our 15 January letter, APRA's prudential mandate focusses on the financial health of the regulated entity. Information received by APRA, whether from complaints by individuals, or from other external sources, is assessed for the existence, or indicators, of prudential risks that warrant attention by APRA. Where information indicates systemic breakdowns or issues that may give rise to a financial or prudential risk to the entity, APRA will take appropriate supervisory action, such as making further inquiries and gathering additional information, meeting with responsible senior executives of relevant regulated entities and either confirming the entity is properly managing action to address the issues, or requiring further action to be taken.

APRA receives a large amount of enquiries to our central contact point (APRAinfo) each year. Since 2012, the total number of calls and emails to APRAinfo, has been around 12,000 per annum.<sup>1</sup> These enquiries cover a range of subjects, with only some relating to specific APRA regulated entities or being of the nature of a complaint related to a regulated entity.

One of the more common topics that the public enquire about through APRAinfo is superannuation (estimated 30 per cent), and this involves a variety of matters in relation to super balances, lost superannuation accounts, and confirming whether a particular fund is authorised by APRA. General financial sector enquiries (20 per cent, including insurance and enquiries not under APRA's jurisdiction), general banking (15 per cent, including dispute processes and enquiries related to use of the word 'bank') and the Financial Claims Scheme (10 per cent) are also common topics. A reasonable number of enquiries (5 per cent) are redirected to other organisations because they are outside of APRA's areas of responsibility. The remainder are unclassified but include enquiries for data submissions to APRA and calls for APRA staff members.

Any enquiries with information in relation to more significant issues or misconduct at an APRA-regulated institution are referred to the relevant supervisory team in APRA for review. A very small portion – less than 0.25 per cent – of the enquiries to APRAinfo are from whistleblowers with information concerning an APRA-regulated entity.

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<sup>1</sup> Prior to November 2011, APRA was responsible for applications for the early release of superannuation and the APRAinfo call centre would receive upwards of 1000 calls each day on this matter alone. After November 2011 the responsibility for early release of super applications was transferred to the Department of Human Services (DHS).

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Where information is provided that may be of possible prudential concern, the information is passed to the relevant supervisory team and a response is provided to the individual which will typically confirm:

- APRA's role and that APRA deals with systemic matters at an entity level rather than pursuing individual complaints about products and services.
- The information has been referred to the relevant supervisory team within APRA and will be assessed for any systemic or prudential concerns.
- Secrecy provisions in the APRA Act mean that we are unable to disclose information about any action APRA may take in relation to a particular regulated institution.
- That any complaint about a financial institution should also be directed in writing to that institution (if this has not already been done).

Where judged appropriate, APRA will refer the complainant to an appropriate agency or complaints body or may pass the information to another agency in accordance with various Memoranda of Understanding.

### **Confidentiality**

In our 15 January letter APRA noted that some of the information in Appendix A and B is 'protected information' as that term is defined in section 56 of the APRA Act and the information provided was disclosed to assist the Commission, for the use of yourself, counsel assisting you and to the solicitors to the Commission.

In accordance with Practice Guideline 1, issued by the Commission on 22 January 2018, we have indicated on the index and appendices provided with this letter where APRA claims confidentiality in respect of information, a document or part of a document. In accordance with Practice Guideline 2, issued by the Commission on 29 January 2018, we have indicated on the index and appendices provided with this letter where APRA claims privilege in respect of a document or part of a document.

### **Information provided**

APRA has provided the material in this response in machine readable PDF format where possible, in line with instructions received with the original 15 December request. We will look to provide any future information requested in accordance with formats in Practice Guideline 1.

Please do not hesitate to approach APRA for any further assistance you may require. The relevant contact at APRA is Robyn McMahon, General Manager, Enterprise Strategy & Risk Division (phone: [REDACTED]; email: [REDACTED]).

Yours sincerely,

