

29 June 2017

Mr Peter Harris
Chairman
Productivity Commission
Locked Bag 2, Collins St East
Melbourne VIC 8003

Dear Peter

APRA RESPONSE TO PRODUCTIVITY COMMISSION REQUEST

Thank you for your recent letter requesting assistance in the Productivity Commission's ongoing work, and in particular assessing the potential impact of recommendations from the *Superannuation: Alternative Default Models - Draft Report* (the report) for Stage 2 of the inquiry.

As you would appreciate, any such assessment is quite challenging and necessarily contingent on a number of assumptions. The possible impact is also likely to vary - potentially significantly - under the different models that are proposed in the report.

To provide some indication of possible impacts, APRA has undertaken analysis using data reported to APRA and some of the key assumptions outlined in the Commission's report to estimate the potential change in registrable superannuation entities' (RSEs') net cash flow ratios over a five year period.¹ We have considered scenarios based on the loss of estimated share of the 'first-timer pool' of default contributions, and the loss of both the first timer pool and the 'turnover pool' of default contributions.² These estimates therefore do not consider other consequential impacts that may occur as a result of possible loss of default status, such as loss of contributions for, or increased rollovers out of the RSE by existing members, and are therefore likely to understate potential impacts.

APRA's analysis indicates that, all other things being equal, the loss of only the first-timer pool of default contributions has a relatively minor estimated impact on the net cash flow ratio of any RSE that operates a MySuper product over the five year period from June 2016. As such, this impact on its own is unlikely to raise any material prudential concerns.

The analysis does indicate that, as expected, RSEs are likely to be more significantly affected by the combined estimated loss of both the first-timer pool and the turnover pool of default contributions. However, the estimated impact of this cash flow loss on its own does not indicate that any RSE's net cash flow ratio would deteriorate to the extent that

¹ Net cash flow ratio is defined as net contribution flows divided by average net assets available to pay members' benefits in a financial year. Net assets available to pay members' benefits represents the surplus of total assets less total liabilities which is underlying the value of members' benefits (this includes reserves). Net contribution flows is total contributions plus net rollovers less benefit payments and are gross of contributions tax and surcharge.

² As per the Productivity Commission's *Superannuation: Alternative Default Models - Draft Report* at page 8.

the RSE licensee may need to consider merging or winding-up within the five year period considered solely as a consequence of this impact.

APRA's analysis included 52 RSEs that offer a MySuper product and are named in a modern award; this identified the quartile of 13 RSEs that would be most adversely affected by a loss of the pools.³ APRA observes that, for this group of 13 RSEs:

- seven RSEs have net assets in excess of \$10bn at 30 June 2016; and
- six RSEs have assets below \$10bn at 30 June 2016.

This group of potentially adversely affected RSEs are generally heavily reliant on default contributions and/or have a weaker net cash flow position as at June 2016. The 13 RSEs include a number that APRA has identified as being in the lowest quartile based on a number of measures that we have considered in assessing the quality and value of outcomes being delivered for members. It also includes some (generally larger) RSEs that may be expected to retain default status (depending on the particular default allocation model that is ultimately adopted) and one RSE in the process of completing a merger.

In summary, APRA's analysis indicates that the estimated immediate impact of the loss of the first timer pool and turnover pool of default contributions on its own would be limited. More pronounced impacts are estimated to occur for RSEs commencing in the third year, particularly under the scenario where both the first timer pool and the turnover pool are lost. This suggests that RSE licensees would have some opportunity to develop and implement strategies to mitigate potential impacts and ensure appropriate outcomes for members of the RSE.

APRA continues to remind RSE licensees that delivering quality outcomes to members demands that their business operations remain sustainable into the future. This requires action from RSE licensees, rather than simply relying on organic growth in assets and membership based on default status to sustain their business. RSE licensees must implement sufficiently robust strategic and business planning processes with a view to ensuring that RSEs within their business operations deliver high quality, value for money outcomes for members over the medium and longer term. RSE licensees with robust planning processes and already providing quality, value for money offerings to members should be well-equipped to respond to future challenges such as changes to the default allocation model. Where this is not the case, the best interests of members are likely to be better served by the RSE licensee considering a merger or transfer of the RSEs under their oversight.

We welcome the opportunity to discuss our analysis in more detail with you if that would assist.

Yours sincerely

Helen Rowell
Deputy Chairman

³ This information was drawn from the Modern awards list on the Fair Work Commission website: <https://www.fwc.gov.au/awards-and-agreements/awards/modern-awards/modern-awards-list>.