15 September 2014

Neil Grummitt
General Manager
Policy, Statistics and International
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001

Lodged by email to: superannuation.policy@apra.gov.au

Dear Sir

Discussion Paper – 'Reporting standards for select investment options'

We refer to the discussion paper, 'Reporting standards for select investment options' released on 7 July 2014.

We enclose a submission to the discussion paper on behalf of the Australian Custodial Services Association (ACSA).

ACSA is the peak industry body representing members of Australia's custodial and investment administration sector. ACSA's mission is to contribute to innovation within Australia's investment administration infrastructure, support the development of custody professionals, and to provide leadership in representing our members.

By maintaining leadership and serving as a hub of quality and influential information, the Association enables members to confidently navigate change and growth. ACSA represents members holding securities in excess of $2.3 trillion in custody for Australian investors as at December 2013, and employing around 4,000 staff.

ACSA would also welcome any further dialogue on the matters identified if that would be of benefit to the consultation.

Yours faithfully

David H Braga
ACSA Chair

THE AUSTRALIAN CUSTODIAL SERVICES ASSOCIATION
Guiding Custodial Endeavour

SUBMISSION TO THE APRA DISCUSSION PAPER, 'REPORTING STANDARDS FOR SELECT INVESTMENT OPTIONS'

September 2014

ACSA Select Investment Option (SIO) Consultation – Overview

ACSA appreciates the opportunity to comment on APRA's Discussion Paper on Reporting Standards for select investment options (the Discussion Paper). We note that the Discussion Paper has been produced in response to industry comment on the complexity of some of the requirements in the standards, with the intent of addressing some of the complexity, or providing further clarification.

After review of the Discussion Paper, ACSA would like to address 2 overarching principles that apply across various sections. Firstly, ACSA has a strong preference that the reporting requirements for Select Investment Options should be consistent with requirements for MySuper options. In addition, we would like to discourage APRA from assuming it can rely on ad hoc reporting by RSE's.

The Discussion Paper includes an assumption that the assets relating to MySuper Options tend to be segregated, whereas the assets of Select Investment Options are not. In ACSA's experience this is not typically the case. Most Super funds tend to have a single investment structure philosophy that would apply equally to all of its options. That is to say, an RSE that has segregated assets for its MySuper option will also tend to have segregated assets for its other options, and conversely, if it has comingled assets for its Select options, they are almost always comingled with the assets of the MySuper Option. Given that a large number of RSE's utilised an existing default option as their MySuper option, in our experience, the majority of funds have a fully comingled asset structure.

While it is helpful that APRA has acknowledged that the data collection for Select Investment Options with comingled assets is highly complex, this also applies equally to MySuper options. Given this information, it is our view that being required to maintain 2 different sets of reporting requirements for options within the same structure will not achieve the kind of simplification APRA is intending.

In addition to this, APRA has stated that the reduction in the data collection requirements for some elements reflects the removal of some "lower priority" items, and "where necessary, APRA could request this information on an ad hoc basis". Given the high degree of complexity within Select Investment Option reporting and the reliance on IT solutions to produce the reports, ACSA is strongly of the view that ad hoc reporting of items not included in automated reporting solution will not be possible. If APRA is of the view that a certain data item may be needed at a point in the future, then it must be included in the reporting system build, and so it would be preferable to include it in the reports. Also, as with comments above, if the reporting item is required for MySuper Options, then excluding it for Select Investment Options within a comingled structure may not provide any reporting benefit to RSE's.

ACSA SIO Consultation – Chapter 2 – Definition of a select investment option

Discussion among ACSA members and other industry participants suggests there are still numerous outstanding questions on the definition of Select Investment Options that could benefit from formal clarification from APRA.

It has become apparent that there are still differing views as to what constitutes an investment option, particularly when discussing member directed investments such as direct shares and member directed term deposit options, as these investment strategies can be constructed and administered in various ways, each with its own implications for APRA reporting.

ACSA is aware of some RSE's who have taken a view that, where member directed investments result in assets segregated at the member level, such as member directed Term Deposits, each separate member holding could be determined to be an Investment Option in its own right. ACSA strongly believes APRA should provide sufficient guidance to clearly avoid such a definition.

ACSA would endorse a 2 step process, whereby RSE's utilise a principles based approach to quantify how many Investment Options it has, and then a separate process to determine how many of those Investment Options meet the threshold as Select Investment Options.

Quantifying Investment Options

The overriding principle is that an Investment Option should represent an investment choice, profile or product offered by an RSE to its members/clients, without regard to the manner in which the investments are held or administered. If an RSE offers members a choice of Term Deposits with 4 different maturities, but no other defining characteristics, then it has 4 Term Deposit Options, despite the fact that each deposit made each day represents a different asset. Similarly, where an RSE allows a member to select an externally administered Direct Shares Investment that allows a member to choose from the ASX top 50 shares, then that represents 50 options, even if all of the assets are held in a comingled portfolio.

As per guidance in FAQ 11, RSE's should then give consideration to the full range of data required for Investment Option reporting in determining if/when it is appropriate to consolidate options across members or products, noting that ultimately the number of Select Investment Options an RSE has is defined in its submission of SRF 001.0, and must be consistent across all subsequent reporting forms for that period.

Where products have different characteristics, such as fee rates or tax treatments, and those different characteristics would result in different data being presented on forms, then RSE's should report them as separate Investment Options.

Defining Select Investment Options

Select Investment Options form a subset of the Investment Options offered by an RSE. The current definition of Select Investment Option, which includes a set dollar threshold of $50m for inclusion in reporting, puts larger RSE's at a disadvantage to smaller ones. Investigation of client data by ACSA members has highlighted that most smaller funds will be required to provide Select Investment Option reporting on only 2-3 options, being those that fall over the 5% limit, with the $50m cap being largely irrelevant. However, a large RSE with assets of $50b would have to provide Select Investment Option reporting on any option greater than 0.1% of its assets, and this can run to dozens, if not hundreds of options.

Given the apparent inequity imposed by the inclusion of a hard dollar limit, and considering that the focus of the Standard is to provide reporting on the options which could materially affect the operations of an RSE, ACSA believe a simple test based on % of RSE assets should be sufficient. ACSA expects this would have no impact on smaller funds, but be a significant benefit to larger funds, while still capturing significant exposures.

We also note that, while these options may be mapped to the requirements of SRS 533.0, it is debatable how much useful information is collected in an asset allocation form for a single security investment option. As a result we would recommend single security investment options are excluded from the definition of Select Investment Options.

Options underlying a reserve

ACSA would support APRA in its decision to remove the limb of the definition referring to investment options underlying a reserve. We would agree that a large number of RSE's invest the assets backing their reserves in default options, or a combination of options that closely represents the total assets of the fund.

Implementation Issues

Maintenance of the 35 calendar day reporting timeframe

With the advent of SIO reporting the volume of reports required to be compiled by RSE's, their custodians and administrators has the potential to grow considerably depending upon the number of select investment option's an RSE may have. The increase in reporting volume will add to the other challenges highlighted in prior ACSA submissions dated 4 September 2013 and 28 November 2013. A potential compression in reporting timeframe may lead to earlier cut-offs of hard closed Fund Accounting valuations and lead to less accurate information due to use of stale prices.

As the SRF 533.1 is on a look-through basis and each SIO may have a proportional share of a significant number of RSE assets, the underlying and supportive audit information required for each report will be only marginally less substantial than what is currently the case for MySuper reporting within SRF 533.0

With this is in mind, ACSA would like to propose that the 35 calendar day reporting timeframe be extended in perpetuity to allow RSE's the ability to ensure that timely look through information has been received and that they have adequate time to prepare, review and validate the significantly increased data set.

Resubmissions of existing reports

ACSA envisages a highly engaged industry response to the SIO discussion paper that may result in a change in the implementation approach of the prudential standards by the regulator. Such changes may not only have an effect on the proposed SIO reporting, but may also touch on the existing disclosure requirements for MySuper or RSE reporting.

Although ACSA welcomes reductions in disclosure that does not have a negative impact on APRA's ability to maintain adequate oversight of the industry, we ask that any changes made to existing reporting standards (or the application of those standards) would not trigger a requirement to re-submit prior period reporting.

Frequently Asked Questions (FAQs)

Due to the sometimes complex nature of investments the FAQs issued by APRA are an integral resource for both custodians and their clients to ensure regulatory reporting submitted is compliant with APRA's intentions.

In a small number of cases the direction given by APRA is contrary to the previously understood application of the standard by the industry. As many of the reports are built from a "bottom up" approach, these changes can have significant impacts on the way in which reports are built from a technical and conceptual view point.

As custodians have built bespoke technology systems to deliver APRA reporting to our clients, the turnaround time for implementing such changes must be measured in months rather than weeks. This is further compounded as any changes need to compete with work currently being undertaken in regards to yet to be delivered forms. ACSA requests for APRA to continue to be mindful of the impact FAQs have on custodians. For example, FAQ 97 took on 3 to 6 months for ACSA members to implement. Although the requirements were not incorporated into the Reporting Standards and were therefore on a best efforts basis, ACSA members received RSE feedback to comply to the FAQ as soon as possible. This meant that planned technology and project work had to be replanned and reprioritised to cater to FAQ 97.

ACSA would ask that APRA provide explicit wording that:

- That the implementation of FAQ's is on a best efforts basis and,
- No resubmissions be required where RSE's are not able to implement the FAQ in the first cycle of reporting following the release of the FAQ.

ACSA is also supportive of any industry consultation APRA will undertake on the consolidation of FAQs into the final reporting standards (forms and instructions).

Timeframe to implement SIO

From our joint experience in implementing the existing reporting forms and the changes that have subsequently been made resulting in ongoing system enhancements, ACSA would like to highlight that the proposed four month timeframe between the finalisation of reporting standards for SIO (mooted as Feb 2015) and the start date (1 July 2015) for application of these standards will be challenging. As SIO reporting differs to the existing MySuper reporting, custodians and RSE's will have to update their systems to create new reports and audit files whilst providing test files to clients and administrators.

As the delivery of the initial MySuper reporting has shown, any subsequent clarifications released via FAQs that differ to the February reporting standards are difficult to incorporate into the initial period's reporting. This will be also potentially compounded depending on the outcome of including member direct products in the definition of SIO's.

ACSA's proposal: Phased approach to reporting SIO

SIO reporting has the potential to greatly increase the volume of reporting prepared and submitted by RSE's and their service providers – this is particularly the case for member direct platforms.

To ease the initial burden in the first year of SIO reporting, ACSA would like to suggest a phased approach that we will believe will strike the balance between reporting the greater proportion of SIO investments to the regulator versus reporting on relatively immaterial investments. The threshold suggested would be the following:

1. 5% of Fund
2. Lesser of 5% or 150 million

ACSA approximates that the above proposed thresholds would cover 6% and 95% respectively, of a RSE's total assets based on ACSA's client base.

Below is a table summarising the structure of the ACSA client base, which substantiates that the suggested thresholds would ensure that the greater portion of RSE assets are incorporated in SIO reporting, whilst avoiding significant reports being produced on minor SIO's.

	Number of Options	>2% of RSE	>5% of RSE	>5% or $50m	>5% or $150m
Total across custodians	1050	312	147	474	269
Percentage of total Options		30%	14%	45%	26%

Consistency of Reporting

Consistency of Reporting

The Discussion Paper provides the following proposed revisions for the SIO reporting requirements:

a. Introduction of new form Reporting Standard SRS 533.1 Asset Allocation and Member 'Benefits Flows (SRS533.1).
b. Removing requirement s under SRS 533.0 to report movements in directly held and indirectly held investments broken down by asset class, domicile and listing type for SIO

ACSA acknowledges that APRA has taken feedback provided by RSE's, Custodians, Industry and other stakeholders in respect to the range of implementation issue that arise for reporting on SIO.

Under the proposed changes, SRS 533.00 and SRS 533.1 will diverge from the current practise of having both the MySuper and SIO forms being consistent. Data for the SIO is gathered and stored in the same way as data for MySuper option, there are no savings from technology build, data gathering and updating of forms since the data elements are available at the lowest level by individual portfolios. This data is then consolidated and split between MySuper and SIO options. Data is stored at the lowest level where there is no distinction between MySuper assets vs. SIO assets.

Custodian's systems are coded as such to only have changes in the underlying reporting data feeding into the forms. Inconsistency of forms will require a duplication of effort, additional reviews to ensure data validity and may potentially increase level of audit /RSE queries due to this inconsistent approach.

(Refer to diagram in the Appendix)

The potential for inconsistency as currently proposed provides custodians with additional ongoing maintenance costs, due to separate forms being required for My Super and SIO. Any changes going forward will need to be applied two sets of form, leading to increase lead times for changes, build and implementation.

Having 2 forms for the different options implies multiple changes rather than limiting changes to one form that is used for both options. ACSA would like to propose that consistency of reporting for MySuper and SIO be maintained going forward.

ACSA would like to propose the following:

Option 1 (preferred option)

SRS 533.1 in its current draft form to be accepted to be used for both MySuper and SIO options. This will ensure consistency of reporting across both streams, will allow for one set of build requirements, and data collection will be as currently stored by Custodians.

Option 2

SRS533.0 to be used for both MySuper and SIO options with the proposed amendments as per form 533.1. This would include requirements per FAQ 97. This will apply for both the MySuper and SIO options.

Applicability of FAQ 97 for 533.1

The paper is currently silent on whether FAQ 97, regarding the reporting of directly held derivatives is to be included or exclude from SRS533.1.

ACSA assumption is that FAQ 97 is applicable to SRS 533.1 to make it consistent with the derivation of values in SRS533.0.

Look through Reporting for Investment Flows

ACSA Understanding of Requirements

Reporting standards SRS 531.0 'Investment Flows' and SRS 533.0 'Asset Allocation' requires RSEs to report on investment flows or profit and loss (P&L) for indirectly held investments or underlying investments of the investment vehicle. Both the instructions in SRS 531.0 and FAQ 61 state the apportionment methodology ('top down') be used where the P&L of the underlying investments ('bottom up') is unknown to the RSE.

Excerpt from SRS 531.0 describing the top down or apportionment methodology:

> *Example: An investment in a wholesale trust is reported as 80,000 Australian domicile listed equity and 1,200,000 International domicile unlisted property in item 3 on Reporting Form SRF 530.0 Investments. The wholesale trust reports to the RSE licensee that year-to-date investment income is 10,000,000, unrealised gains are 20,000,000 and realised losses are -5,000,000 with no foreign exchange gains/losses. The RSE had a net purchase of an additional 30,000,000 units in the trust. If the RSE licensee has no further information on the breakdown of these numbers to specific asset classes, report item 2 as:*

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Equity	Australia	Listed	NA	NA	12,000	4,000	8,000	-2,000	6,000	0
Property	International	Unlisted	NA	NA	18,000	6,000	12,000	-3,000	9,000	0

ACSA Challenges

As is process:

Current treatment of investment flows from external investment vehicles – where a RSE holds units in an investment vehicle:

- All gains and losses (realised, unrealised or foreign exchange) are recognised at the investment vehicle level, as per Australian accounting standards
- Fund Managers do not provide such a P&L breakdown per underlying security of the trust to unit holders. The look through data provided by Fund Managers to date are at an asset allocation level, which only allows for only the top down or apportionment methodology to be adopted.
- This is likely to continue with no explicit legislative requirement for Fund Managers to provide RSEs data for APRA Reporting and Portfolio Holdings Disclosure not requiring P&L data.
- The gains and losses derived from the investment vehicle holding are captured through the trust distribution calculation process. The trust distribution process captures the comingled gains/losses on from the underlying investments of the investment vehicle, as well as any tax adjustments (such as prior year losses) to arrive at the taxable income or loss of the trust for that financial year that is distributable to unit holders. This calculation is representative of the income from the underlying assets that is due to the unit holder.

Using the example above, 10,000,000 (excerpt from SRS 531.0), the investment income of the wholesale trust would be the only investment income recognised by the RSE in their financial statements and would represent the distributions of the investment vehicle.

Challenges:

As detailed in ACSA's submission to APRA on the 24 July 2013, the bottom up methodology poses the following challenges and diminishes the value of reporting the P&L of the indirectly held investments or underlying investments of the investment vehicle (bottom up):

- *Does not align with accounting standards and RSE Financial Statements resulting in the inability for RSEs to comply with section 29QC:* as detailed above, the income distributed to unit holders is recognised in the RSE's financial statements as the investment income derived from the investment vehicle, which is also compliant with the Australian accounting standards.
- In the 21 March 2014 joint letter from APRA and ASIC on the administration of section 29QC of the Superannuation Industry (Supervision) Act, it stated that, *"As a result of section 29QC, an RSE licensee is required to adopt the calculation methodology prescribed by APRA in a reporting standard where the RSE licensee gives information to another person that is the same or equivalent to information provided to APRA under that reporting standard."* As RSEs are required to report the investment income derived at the investment income level in their financial statements, as per the accounting standards, it is not possible to adopt the same bottom up methodology as prescribed in the APRA Reporting standards. This will result in RSEs contravening section 29QC.
- *Unit holders have no claim to individual securities or the income of the investment vehicle:* even if the P&L of the indirectly held investments can be reported, it is not representative of what the RSE truly has exposure to or has claim over
- *Does not reflect the true investment flows of the investment vehicle:* movements in underlying securities do not have a perfect positive correlation with the investment income distributed by the investment vehicle. That is, the movement of underlying investments will not result in a dollar to dollar movement with the investment income actually received by the RSE from the investment vehicle.
- *Does not reconcile with SRS 330.0 'Statement of Financial Performance' Item 4.5 Investment income as required by the instructions:*
  - SRS 330.0 must be reported in accordance with the Australian accounting standard, unless otherwise instructed. There is no explicit instruction to report Item 4.5 on a look through basis. That means that SRS 330.0 Item 4.5 will reflect the investment income at the investment vehicle level.
  - The instructions do specify that Item 4.5 must equal that sum of Item 1 Column 7 and Item 2 Column 7, which is the sum of Investment Income for directly and indirectly held investments. The sum of the two items would include bottom up P&L.

Cost

As the P&L and the holdings of the investment vehicle would change daily, in order to accurately capture and report P&L on each underlying investment, Fund Managers would need to:

- Track when each unit holder has bought and sold into the investment vehicle so that P&L of each underlying investment held that day can be allocated to a unit holder on a daily basis
- Distribute individual statements to each unit holder or third party look through vendors with each RSE's unique P&L

Implementation of daily reporting specific to RSE unit holders for APRA Reporting purposes will also result in inconsistent amount of investment reported to each unit holder. For example, for retail unit holders, the Fund Manager would only report as at the end of each quarter or half year with investment income reflected as a return per unit held and no granular breakdown of this return per underlying investment.

ACSA estimates the cost of implementation of bottom up investment flow reporting to the industry to be:

Party	Activity required	Cost per RSE p.a. (Quarterly)	Cost per RSE p.a. (Daily)
Fund Manager	*Ongoing cost:** Calculation individual unit holder statements	$400,000	$2,500,000^
Custodian	*Incremental ongoing costs:** - Incremental cost of obtaining P&L data from third party vendor - Additional checks and investigation, which cannot be automated as the look through P&L will not reconcile to existing accounting data	$4,800	$300,000
	Once-off implementation: - Receipt of third party vendor data - Separate storage of look through P&L data (needed exclusively for APRA reporting)	$120,000	$120,000
	Total Cost per RSE p.a.	$524,800	$2,920,000
	Total Cost across ACSA RSE client base p.a.	$52,480,000	$292,000,000

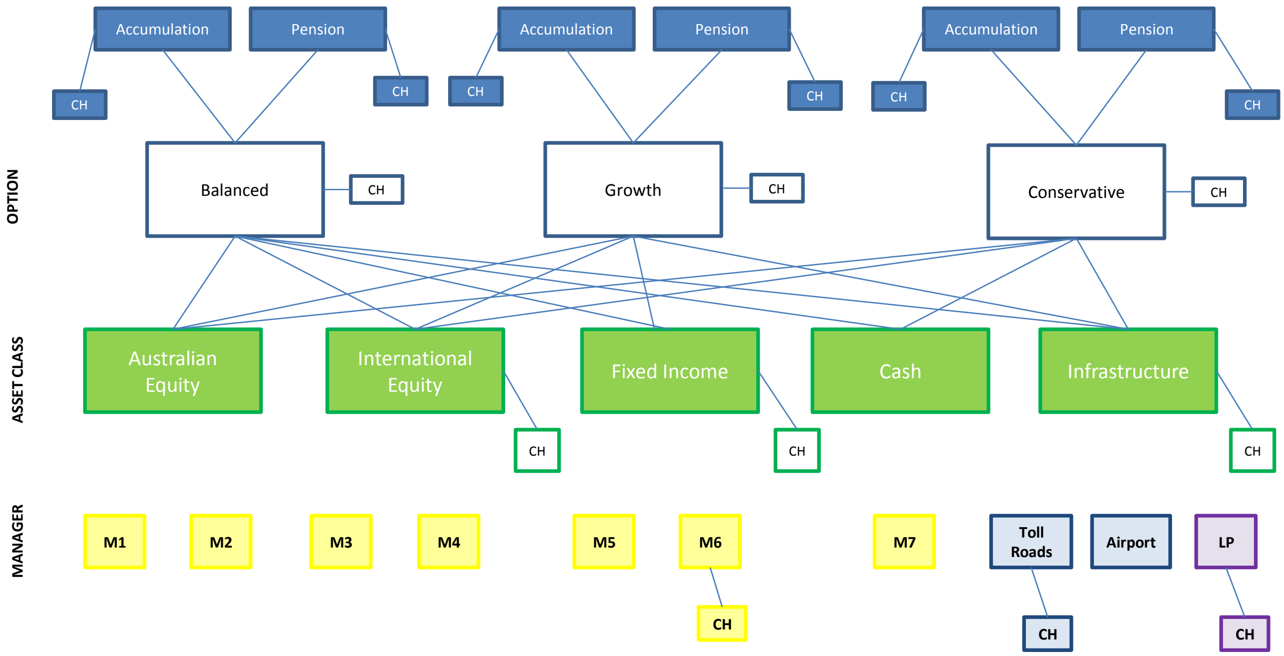
*: Range of cost captures the frequency of profit and loss capture by the Fund Manager, from quarterly (minimum frequency for APRA Reporting) to every business day. This cost would then be passed onto the RSE as it is a specific process to support RSE regulatory reporting. Average investment vehicle holdings across the ACSA RSE client base were used.

^: Fund Manager cost to calculate and report on individual unit holder statements was based on current distribution calculation costs, which ACSA sees as an equivalent activity

ACSA Proposal

In ACSA's view, the cost to implement and report outweighs the relatively small value in obtaining and reporting the P&L of investment vehicles using the bottom up methodology. ACSA proposes that the top down or apportionment methodology be the only methodology to derive the investment flows for indirectly held investments, regardless of whether information is received from the Fund Manager.

Appendix



Note: "CH" = Currency Hedge.
This diagram depicts how they can be employed at any level of a Super Fund structure