

THE IMPACT OF NEW REPORTING STANDARDS ON THE OPERATIONS OF FUNDS AND THEIR ADVISERS



How are the people responsible for ensuring accurate and timely measurement of the financial performance and compliance obligations coping with new APRA requirements? A group of chief financial officers, their advisers and service providers met to discuss the issues.

“All funds agree that there needs to be more information delivered to the regulator. None is King Cnut and trying to push back the tide. It is really what the regulator and funds feeds back to the public, that is the question.”

John Creeley, chief financial officer of First State Super sums up the thoughts of many on portfolio disclosure. There is a keenness for greater transparency, but mystification as to the effectiveness of portfolio disclosure in its current guise.

One theory is that APRA primarily wants to create an online database of information, so that trends in investment could be analysed.

However, Creeley thought the imperative was for APRA to be seen to be taking action now, following the Trio fraud. “They can consult for another five years and still not come up with a better answer, so they have pushed the button and said, ‘Let’s go with this, and then it will evolve as we have

evolved the banks and insurance.’”

Most of the panel were doubtful as to whether portfolio disclosure gave meaningful information.

John Rodd, chief financial officer of Equip, said that while it was reasonable to expect members to see what their fund was invested in, it was a flawed premise to expect members to understand why the securities were owned in the first place.

“One thing that is never discussed about superannuation is the investment risk we are taking and managing for our members,” he said.

Several speakers made the point that data running into tens of thousands of items would if anything hinder member comprehension.

It was the suggestion of Creeley that APRA should conduct consumer testing to see what volume of information was desired.

He was also optimistic that eventually portfolio disclosure, if done properly, would eventually prove its worth.

“Super will be the biggest asset of the next generation, and the generations thereafter, if property affordability remains where it is, because they will be a generation of renters,” he said. “They will, therefore, have more motivation to be engaged with their super, because that is their biggest asset.”

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from principle, or at least ameliorating the application of that principle to some extent, so that it does work.”

Though, current levels of disclosure have their fans. Sacha Vidler, chief economist at Industry Superannuation Australia said that if the whole industry has greater transparency around investments and costs then this will lead to prices coming down.

“(Transparency) costs something to produce, but it is not without value and that efficiency will be returned to the market,” he said.

One of the hardest parts of disclosure is around private equity, hedge funds and infrastructure. David Braga, chair of the Australian Custodial Services Association (ACSA), said look through data was currently only being received for 25-50 per cent of unlisted investments and ACSA analysis suggests that in the lead-up to the first round of reports it is likely valuations will only be received for 85 to 90 per cent of unlisted investments.

Part of the problem is getting the information in time, part of it is getting it at all. For infrastructure, pricing could take well over the 30 days needed for reporting periods, while hedge funds and private equity firms will resist giving away price sensitive information.

There is widespread fear that fund managers in this position will either bump up their fees for Australian investors or simply walk away.

Disclosure of fees is a potential worry too.

John Dyer, chief financial officer of Unisuper, said: “If you have four or five funds with the same manager and there is a differentiation between the fees –if somebody has got a better deal, they might not want that made public.”

Another issue is the diversity of information from alternative managers depending on their international jurisdiction. Girgis pointed out: “A limited partnership in Massachusetts has a different structure and feel, and a different legal characteristic, to one in Rhode Island in the United States; something as vague as that

Disclosure of course comes with a cost.

Mark Neary, managing director, business development, Asia-Pacific, Milestone Group, contrasted the disproportionate costs on superannuation, compared to banking and insurance which already hold most information in-house.

“This industry has a federated network of suppliers which makes it very hard to get information efficiently within tight time frames and to do this there are real costs,” he said. The level of data scrutiny needs has to be higher to ensure consistency and he foresees a lot more data alignment issues between source providers.

He also saw added complexity from the competing demands of ASIC and APRA.

“A seemingly minor difference between the APRA and ASIC implementation potentially leads to project scope challenges, unintended resourcing levels and consequently budget impacts. Understandably, the funds are being very careful in watching how portfolio disclosure requirements unfold.”

For Maged Girgis, partner at Minter Ellison, the principles for consistency of information and for transparency are getting lost in translation.

“If I was looking for anything from that treasury review, it would be to look at whether translation of a principle really works. If it does, all well and good; if it does not, maybe it is a matter of departing



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ROUND TABLE

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can suddenly switch around whether you are investing in a body corporate, or a limited partnership, or a hedge fund, from a legal perspective.”

Neary made the point that not only unlisted investments be reported in different ways by individual fund managers, but that there would be timing issues from them too, which would make the value of the data questionable.

It is hoped that APRA will come up with a pragmatic solution.

Girgis said: “Should there be some ability to asterisk certain information and send a message to APRA to say that there is a good reason why it is not communicated? There is facility in the act for them to not release information. They have the power to.”

The information required by APRA is housed at investment managers, custodians, insurers and administrators. How are funds coping with the differences in reporting styles from these providers?

ACSA has prepared an industry-wide standard to enable custodians to help their clients. David Braga said: “We expect this to remove ambiguity and avoid situations where each custodian must do its own bespoke classification.”

In theory this means the custodians will do much of their client’s heavy lifting. John Creeley believes this is the case. “The effort we have seen our custodians put into this is substantial. They have had a dry run and we have had the first quarter, so we can see that the hard close and the APRA reports will tie up.”

ACSA also has concerns that the 28 calendar day reporting deadline is not appropriate due to the diverse nature of the assets normally used by superannuation funds.

Braga said: “While the custodian’s role is very early in the reporting process, we are reliant on having closed books for the period so the process can’t begin until the accounting books are put through a ‘hard close’. This also means custodians are put through significant time pressures



Sacha Vidler



David Rowley



John Creeley



Maree Pallisco

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in order to verify and consolidate all the information.”

One extra complication caused by the APRA standards; is how the asset class definitions impact on the way a fund has traditionally explained its asset allocation for each of the choice options. Under SIS Act S29QC funds are now required to keep published information consistent with the information reported to APRA.

John Rodd of Equip said that the industry to date has grouped securities into asset classes based on the securities risk profile and has used risk language to describe how it manages the investment risk inherent in the options’ investment strategy to help educate members. “If the APRA definitions for asset classes are used, then all the member will know is what the securities look like and not know how the securities will behave. eg distressed debt; subordinated debt; government debt are all fixed interest type securities but have a completely different risk profile and are used differently by funds in their portfolio construction.”

Creeley also sounded off on the process of extracting information from insurers, which he thought was duplicating work already done by APRA. “Given that APRA regulates insurers, why cannot they just go to the insurers directly? I cannot see the extra value of having the funds provide this information in a format.”

How much extra reporting should CFOs give to boards, given the high standards of compliance facing trustees?

What chief financial officers explain to boards should come as part of a transition process lasting at least 12 months, while the fund gets comfortable with the new standards, according to Maree Pallisco, partner at EY.

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Mark Neary



Maged Girgis



John Dyer

“At least for the first time around, the extent of the changes needs to be made clear to the board, and how, as management, you are extracting and testing, or challenging, the data to make sure that what is going into the forms is accurate.”

This will help boards get an overview of how the process was created, giving them a confidence in the new approach taken by the CFO, believes Pallisco. Additionally boards should know that not all forms are audited, some have limited assurance and some have reasonable assurance. Going forward, boards will need to rely on representations made by the CFO and the auditor and identify high risk areas where it could request further information or clarification.

From a legal perspective boards also need to be aware of the \$8500 fine for missing a quarterly report deadline.

Is there clarity on the definition of ‘reasonable’ or ‘limited’ requirements for auditing returns?

Existing standards of what a limited and reasonable assurance will need to be adapted to the new reporting standards, according to Pallisco. The Auditing and Assurances Standards board is currently working towards a guidance statement on this matter.

One potential stumbling block here is a lack of understanding between an auditor and a superannuation fund about what the law requires.

Girgis said: “Quite often auditors will have a certain perception of what the law requires, and this will quite often be different to what a fund thinks it is. The fund will operate a certain way, obviously, on the basis of what it thinks is the right way of doing it. They will then get the surprise when the audit report comes out.”

Creeley said: “The fund should be on the front foot engagement

Participants

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John Creeley
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Maree Pallisco
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David Braga
Chief executive, ACSA

with the auditor, and if the fund is not, the auditor should be on a front foot engagement with the fund.”

What processes are CFOs using to help them comply with new APRA reporting standards?

Creeley thought that getting comfortable with the process and automating it would take time. “Very few people would use the integrated solution for Q1, but some of them would be looking at Q2, Q3 or Q4, or annual integrated solutions. Therefore, there has to be an adaptive part of saying: here is how we did this quarter; what lessons can we learn to do it better?”

He though a ‘push the button’ solution, where technology can pick up information, recuts it and sends it off was probably two years away.

Neary agreed that technology would play a key role, but that was only part of the journey.

“Like all good technology solutions, they must be grounded in operational procedures and controls in the hands of people with the right skills,” he said. “The challenge will be that over time, skills will have a greater premium, costs will go up and operational timelines will naturally compress.”



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