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16 October 2017

The Secretary  
Senate Standing Committees on Economics  
Parliament House  
CANBERRA ACT 2600

**By Email:** [economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au)

Dear Mr Fitt,

***Answers to questions on notice: Inquiry into the Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017, Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017 and Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 2) Bill 2017***

During the hearings in Sydney on Tuesday 10 October, I was asked a number of questions which I took on notice relating to:

- Financial arrangements for ISA, advertising expenditure and related performance metrics;
- Investment performance of superannuation cash investment options;
- Governance reforms in the Netherlands.

**Financial Arrangements of Industry Super Australia (ISA):**

ISA revenue for the year ending June 2017 was \$21.7 million. ISA receives scaled contributions from 16 member funds based on fund size for the express purpose of undertaking collective projects on behalf of these funds with the objective of maximising the retirement savings of their five million members.

These projects include research, policy development, government relations and advocacy as well as the well-known Industry SuperFunds Joint Marketing campaign. In coordinating and executing these outputs for ISA member funds, economies of scale are realised yielding significant savings compared to each undertaking these activities individually.

ISA's policy research program increased significantly over the past year including major new research on unpaid superannuation, the gender super gap, housing affordability, superannuation tax reform, investment in agriculture, and multiple detailed submissions to Government legislation and reviews including the Productivity Commission Review into superannuation efficiency and competition.

ISA expenditure on specific consumer advertising sought by members of the committee and specific performance metrics related to their success are understandably commercial in confidence.

All of ISA's member funds disclose to APRA their investment, operational and administrative expenses on a quarterly basis. The reporting items specifically include or otherwise capture expenditure relating to advertising. According to the latest APRA Quarterly Performance Statistics Industry Super Funds ratio of administrative and operational expenses to cashflow adjusted assets was 0.34%. This outcome is less than

half the 0.74% for retail sector funds<sup>1</sup>. Annual reports to members and fund websites also include audited financial statements with total expenditure on fund activities pertaining to administration and operations (which include advertising, publications and websites) and investment.

As well as satisfying the requirements of the Superannuation Industry Supervision (SIS) Act in all respects funds must also comply with relevant APRA prudential standards and submit themselves and relevant service provider arrangements to regular prudential review.

Further I would refer the Committee to evidence provided to hearings of the House of Representatives Economics Committee – *Review of 2016 APRA Annual Report* on 13 September 2017 - where Mr Steven Glenfield, General Manager Specialised Institutions Division APRA, responded to questions about ISA's advertising and his satisfaction with its consistency with members' interests<sup>2</sup>.

Industry Super Funds continue to deliver net outperformance compared to retail peers demonstrating they are leveraging scale to reduce expenses and efficiently invest to maximise long term returns. Again the latest APRA quarterly performance statistics<sup>3</sup> reveals the outperformance of industry funds is widening confirming the commercial strategies implemented by funds are in members interests.

### **Cash investment options:**

Table 1 below provides summary performance statistics for superannuation cash investment options by sector over 1, 3, 5, 7 and 10 years drawn from SuperRatings fund and pension crediting rate surveys June 30 2017. Differences in weighted average option returns are consistent between industry and retail sector varying between 0.8 and 1.5 percent p.a and persistent over the short medium and long term.

**Table 1: Average Cash Option Investment returns**

	Accumulation					Pension				
	1 yr	3 yr	5yr	7yr	10Yr	1 yr	3 yr	5yr	7yr	10Yr
Industry	1.84	2.09	2.41	2.97	3.47	2.22	2.50	2.85	3.52	4.06
NFP	1.79	2.04	2.35	2.90	3.41	2.01	2.30	2.62	3.26	3.91
Retail	1.03	1.30	1.46	1.99	2.60	0.80	1.15	1.39	2.02	2.72
<b>Ind - Ret</b>	<b>0.8</b>	<b>0.8</b>	<b>1.0</b>	<b>1.0</b>	<b>0.9</b>	<b>1.4</b>	<b>1.4</b>	<b>1.5</b>	<b>1.5</b>	<b>1.3</b>
<b>NFP - Ret</b>	<b>0.8</b>	<b>0.7</b>	<b>0.9</b>	<b>0.9</b>	<b>0.8</b>	<b>1.2</b>	<b>1.2</b>	<b>1.2</b>	<b>1.2</b>	<b>1.2</b>

Source: SuperRatings Fund and Pension Crediting Rate Survey June 2017 – weighted average of options with assets recorded

<sup>1</sup> APRA Quarterly Performance statistics June 2017 tables 3C and 5C (Sum of Administrative and Operational Expenses / Cashflow Adjusted Assets for four quarters to June 2017)

<sup>2</sup> Official Committee Hansard House of Representatives Standing Committee on Economics, Australian Prudential Regulation Authority annual report 2016, 13 September 2017 (See p 10-11)

<sup>3</sup> APRA Quarterly Performance Statistics June 2017, 5 year ROR outperformance in June 2017 was 2.1% per annum compared to 1.7% per annum in June 2010 (Industry compared to Retail Sectors).

Notably the performance gap is greater for pension cash options suggesting retail funds may not be fully passing on the benefits of the zero tax rate in the pension phase and / or exploiting the larger allocation the pension phase demographic may have to cash.

As noted in my testimony, option to option performance differences between industry and retail offerings are evident across all multi asset and single asset classes over almost every time period reported by SuperRatings<sup>4</sup>. This provides robust conformation that performance differences evident in sectoral and fund level returns are representative of outcomes regardless of the investment option type members are invested and their actual or perceived risk preferences. In other words it exposes the fallacy retail sector underperformance is due to different asset allocations arising from risk preferences and demographics.

#### **Dutch Pension Funds Reforms and testimony from Jeremy Cooper:**

Over 80 per cent of employees in the Netherlands are members of industry-wide and company-level occupational pension funds with boards that operate according to equal representation principles i.e. boards should normally comprise equal numbers of directors nominated by the representatives of employers and employees. This has been the case since the 1960s and remains the case today.<sup>5</sup>

Equal representation boards are commonly referred to as 'paritarian boards' in the Netherlands. Such boards are regarded as having helped to cultivate a high level of social solidarity and confidence that funds are being operated only to benefit members.<sup>6</sup>

The high quality of Dutch pension fund governance is among the reasons that the Dutch pension system was ranked as the best in the world by the Mercer-Melbourne Global Pensions Index in 2009, 2010 and 2011. Since then the Dutch system has been ranked as second only to Denmark – another country where equal representation boards are the norm.<sup>7</sup>

In 2014 the Dutch Labour Foundation (a joint union-employer body), in collaboration with the Federation of the Dutch Pension Funds, published a new 'Code of the Dutch Pension Funds'.<sup>8</sup>

This Code contained suggestions for how Dutch pension funds could model their governance arrangements. These suggestions included giving consideration to appointing 1 or 2 external/independent members to a board if a fund believed such appointments would be in the best interests of members.

The Code is principles-based and does not prescribe appointing external members. Funds can adopt some, all or none of the Code depending on their particular circumstances. Where funds have complying equal

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<sup>4</sup> For example see SuperRatings report Fee and Performance Analysis for AIST March 2017 <http://www.aist.asn.au/media/965926/aist-17performancefeeanalysis.pdf>

<sup>5</sup> Federation of the Dutch Pension Funds communication to Industry Super Australia, 13.10.17

<sup>6</sup> Clark, G. and P. Bennett (2001) 'Dutch sector-wide supplementary pensions: fund governance, European competition policy and the geography of finance,' Environment and Planning A, Vol. 33, pp. 27-48.

<sup>7</sup> See Melbourne-Mercer Global Pensions Index for the years cited: <https://www.globalpensionindex.com/>

<sup>8</sup> Federation of the Dutch Pension Funds (2014) Code of the Dutch Pension Funds, Amsterdam.

representation arrangements, they are free to continue with those arrangements if they believe them to be in the best interests of members.<sup>9</sup> If required ISA would be happy to facilitate communication between the committee secretariat and the Federation of Dutch Pension Funds to confirm these arrangements.

These reforms differ markedly from the proposals in the Trustee Arrangements Bill which seek to abolish the existence of equal representation from the SIS Act and instead impose a mandated quota of independent directors based on a prescriptive definition.

The existing arrangements in the SIS Act<sup>10</sup> and relevant prudential standards and guidance issued by APRA<sup>11</sup> in practice operate in much the same way as the Dutch system with funds required to carefully consider the composition of their boards, their skills and expertise, and consider including representation from independent and non-affiliated directors.

A recent survey of Industry Super Fund trustee boards by ISA indicates a high level of diversity among boards with almost 15 percent of directors satisfying the existing independence definition in the SIS Act and a further 20 percent of directors appointed from outside the ranks of the relevant employer and union sponsors (non-affiliated directors).

Thank you again for the invitation to provide testimony on these important Superannuation Bills.

Kind regards,

Matthew Linden  
Director Public Affairs  
Industry Super Australia

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<sup>9</sup> Federation of the Dutch Pension Funds communication to Industry Super Australia, 13.10.17

<sup>10</sup> Superannuation Industry Supervision (SIS) Act Part 9

<sup>11</sup> See APRA SPS 510 Governance, SPS 520 Fit and Proper, SPS 521 Investment Governance, SPG 510 Governance