# ACTU Submission to Senate Economics Legislation Committee Inquiry into Proposed Superannuation Laws Amendment Act (Strengthening Trustee Arrangements) Bill 2017

**D No.116/2017**
**29 September, 2017**

## Introduction

The ACTU lodged a submission on 22 October 2015 in response to a Senate Economics Legislation Committee Inquiry into the proposed Superannuation Legislation Amendment Act (Trustee Governance) Bill 2015. After reference to the Committee stage in the Senate, this proposed Act was not proceeded with. At that time, it was proposed that Industry Superannuation Australia (ISA) and the Australian Institute of Superannuation Trustees (AIST) would commission a review into Board Governance of Not for Profit Superannuation Funds, to be conducted by Bernie Fraser, AO. The proposed Act was not reintroduced into the last Parliament.

The Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017 is essentially in the same in format and intent as the Superannuation Legislation Amendment (Trustee Governance) Bill 2015 and as such the ACTU re-submits its earlier Submission to the proposed 2015 Legislation as its Submission to this Inquiry. Attached to this Submission is the ACTU Submission to the 2015 Legislation (D No.143/2015) – see Attachment 1.

However, given that an amount of time has passed since the ACTU's Submission was lodged, the ACTU seeks to supplement its Submission by adding a number of comments as detailed below.

## Mr. Fraser's Review

Former Reserve Bank Governor Bernie Fraser conducted a review into Board Governance for Not for Profit Superannuation Funds, commissioned by ISA and AIST. This review was completed in early 2017, and is attached to this submission (see Attachment 2).

Mr. Fraser found that Industry Super have a culture which leads to superior performance standards; and to ensure this culture continues, it is important that Trustees are not chosen on a mandatory basis. Trustees should be chosen if they support the values which underpin superannuation, and have contributed to Industry Super's success.

*"From their beginnings NFP funds have been decidedly member focussed and, in a relatively short period, have established an enviable reputation for delivering strong performance and quality services to their members. The close collaboration between sponsoring organisations and their Boards has been a major contributor to this success and the development of a unique culture."*[1]

Mr Fraser carefully examined the arguments put forth in the Explanatory Memorandum of the 2015 Bill, and came to the view that each of those arguments were unsustainable or did not contribute to the culture which maximises outcomes for members. He found that these arguments were based on assertions, not evidence.

Mr. Fraser found that the Industry Super model significantly outperforms retail funds, so the Governance arrangements are not broken. Mandating the appointments and capabilities of independent directors is prescriptive and Mr Fraser believes that the principles-based approach is a feature of the sector.

Mr Fraser advocated that not mandating this change would increase strength and diversity in the sector. A number of recommendations were made in the report to build on the strength of not-for-profit superannuation, and these have been adopted by AIST. The code is attached, and currently being adopted by funds (see Attachment 3).

Industry Funds have demonstrated that they will establish high-standards for corporate governance and continue to foster a culture of professionalism and innovation which has been a hallmark of the sector. This behaviour is why Industry Funds have outperformed the banks in every level, and achieved more for members.

The table below illustrates how Industry Funds outperform for-profit funds in each measured period.

| | 1 year | 3 years | 5 years | 7 years | 10 years |
|---|---|---|---|---|---|
| **Industry Funds** | 8.95% | 7.56% | 10.1% | 8.84% | 5.28% |
| **For-profit funds** | 5.45% | 4.98% | 7.61% | 6.34% | 2.9% |
| **Industry Fund Outperformance** | **3.5%** | **2.58%** | **2.49%** | **2.5%** | **2.38%**[2] |

This table demonstrates that the outperformance of industry funds, as commented on in our 2015 Submission, has not only continued but has increased to more significant levels. Further data reported by ISA using APRA Quarterly Statistics has previously verified these outcomes.

[1] Fraser, Bernie, (2017), *Board Governance of Not for Profit Superannuation Funds*, p. 33
[2] SuperRatings Fund Crediting Rate Survey July 2017

The legislation put forward is not based on actual performance of Industry Super Funds, nor any evidence that they might underperform in the future. The Government wants Industry Super to mimic corporate governance in the banking sector.

If this were the case, there would be huge damage to workers' retirement savings, a public policy failure and would work against the national interest.

The Committee should note that since the introduction of Governance legislation in 2015, there has been no reported instance of governance failure within not-for-profit super. Industry Super continues to maintain the highest possible standards. This should be held in stark opposition to the continued and systemic failures highlighted in the public record of retail superannuation and the big banks.

## Banks and Super

Given the public record of banking governance failures, criticism is rightly made of the banking sector and its governance processes. The distribution of financial services and products through an agency approach regularly leads to conflicts of interest, where agents will 'up-sell' for their own and the banks financial gain. This is rarely the best product for the consumer, and a lack of effective governance controls has led to scandal after scandal. It is often too late, and far too much damage done, when the client realises they've been sold the wrong product or ripped off.

The ACTU has prepared a list of such scandals from the time the Governance Bills were first introduced in 2015. This list is non-exhaustive, and more to be found (like Timbercorp, Westpoint and Storm Financial) in our original submission.

The Government's explicit aim in their campaigns is to make Industry Funds look and operate like banks, and to give banks a greater level of access to the default fund, and superannuation in general.

It would be against the national interest to enact legislation to give any organisation with such appalling records of governance failures greater access to the retirement savings of Australian workers.

## Summary of ACTU Position

The ACTU wishes to reiterate its position in respect of governance of superannuation. To this end, the ACTU asserts the following:

1. Superannuation is workers' money. Working people and their representatives should have at least equal say over how that money is protected and managed. This is how industry super has operated for 30 years and this is how the savings of workers has grown and prospered, on an "all profits to members' basis", into what has become a significant part of a world-leading retirement system.

2. The Government's proposals seek to reduce the level of participation by workers and their representatives into the superannuation system – to effectively pass control to a structure which mirrors corporate financial structures. The ultimate effect of this will be to transfer wealth from ordinary working Australians to financial entities and to financial elites.

3. The all profits to members' system has demonstrably worked as the most successful superannuation savings system in this country's history. It significantly outperforms its retail rivals and does so in an environment free from the type of mismanagement of corporate governance we have repeatedly seen from the banking sector.

4. Mandating fixed numbers of Independents, who invariably will come from a corporate world and a corporate culture will change the balance within industry super and inevitably change the industry fund culture. A principal tenet that workers' representatives on industry fund Boards understand is that the savings they deal with is workers' money – and the custodianship and investment of that money, in the workers' interest, is the principal objective of those representatives.

5. This is a proposal by the Government that does not seek to fix a problem – the Government cannot identify a problem with industry funds with their governance or with their performance. As a matter of common logic, the Government should be seeking to identify the problem they are seeking to fix and how any proposal they wish to be considered will address that problem. In truth, there is no factual problem which the Government can identify. In fact, all the evidence points to the outcome of the Government's proposals being that a negative outcome will be achieved – that if there is a change of culture in favour of a banking/financial culture it will most likely end in the delivery of outcomes which are inferior to that which is currently being achieved. This will be to the detriment of workers and to the public policy outcomes which have been built over the past 30 years.

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## Timeline of Bank Governance Failures

## 2015

**Commonwealth Bank of Australia** (CBA) will refund around 8,400 customers approximately $7.6 million after it failed to apply fee waivers and ongoing benefits to some customers over a number of years.[3]

Around 200,000 customers are to be compensated approximately $13 million dollars after **ANZ** failed to accurately apply bonus interest to Progress Saver Accounts (PSA) for a number of years. The refund payment includes an additional amount to recognize the time elapsed since the initial breach. [4]

**Commonwealth Bank of Australia** (CBA) will refund approximately $80 million to around 216,000 Wealth Package customers as compensation for failing to apply fee waivers, interest concessions and other benefits since 2008. The refund payments include an additional amount of interest to recognise the time elapsed since the relevant benefit was not applied.[5]

## 2016

**CommSec** pays $700,000 in infringement notice penalties and refunds $1.1 million in brokerage for breaching Market Integrity Rules.[6]

**Commonwealth Bank** staff were allegedly complicit in a $76 million Ponzi scheme and received secret commissions for their role in the alleged fraud, which was ignored by the bank's management for almost five years - until police were alerted. Mildura plasterer Jim Barker and wife Debbie were the first to raise the alarm when two unauthorised withdrawals totalling $26,000 were made from Ms Barker's account.[7]

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[3] ASIC, 15-298MR CBA to refund $7,600,000 after failing to apply benefits, 19 October, 2015 http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-298mr-cba-to-refund-7-600-000-after-failing-to-apply-benefits/

[4] ASIC, 15-330 MR 15-330MR ANZ to pay $13 million after failing to accurately apply bonus interest, 12 November 2015 http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-330mr-anz-to-pay-13-million-after-failing-to-accurately-apply-bonus-interest/

[5] ASIC, 15-355MR Commonwealth Bank to refund $80 million after failing to apply benefits, 25 November 2015, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-355mr-commonwealth-bank-to-refund-80-million-after-failing-to-apply-benefits/

[6] ASIC, 16-289MR CommSec pays $700,000 in infringement notice penalties and refunds $1.1 million in brokerage, 2 September 2016, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-289mr-commsec-pays-700-000-in-infringement-notice-penalties-and-refunds-11-million-in-brokerage/

[7] Houston, Cameron and Vedelago, Chris, (4 February 2016) Commonwealth Bank staff implicated in alleged $76m fraud, http://www.smh.com.au/business/banking-and-finance/commonwealth-bank-staff-implicated-in-alleged-76m-fraud-20160204-gmllia.html

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**CBA** pays $180,000 in penalties and will write off $2.5 million in loan balances for four infringement notices totalling $180,000 in relation to breaches of responsible lending laws when providing personal overdraft facilities.[8]

A former **ANZ Bank** financial adviser was jailed for stealing nearly $1 million from two elderly clients. Justice David Porter said Mr. Drake took $925,085 from a 94-year-old woman and $15,850 from a 71-year-old man.[9]

**ANZ** to refund around 25,000 customers approximately $5 million after it failed to properly apply some fee reductions and fee waivers for customers.[10]

Following concerns raised by ASIC, a review of **ANZ's** OnePath following breaches resulted in compensation of approximately $4.5 million. ASIC sought the review following a significant number of breaches reported by the ANZ Group in relation to its life, general insurance, superannuation and funds management activities.[11]

**Westpac** refunds $9.2 million after charging account fees it promised not to for 161,414 customers over six years.[12]

[8] ASIC, 16-308MR CBA pays $180,000 in penalties and will write off $2.5 million in loan balances, 14 September 2016, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-308mr-cba-pays-180-000-in-penalties-and-will-write-off-25-million-in-loan-balances/

[9] Killick, David, (5 April 2016), *Hobart financial adviser Kenneth David Drake behind bars over $940,000-plus fraud*, The Mercury, http://www.themercury.com.au/news/scales-of-justice/hobart-financial-adviser-kenneth-david-drake-behind-bars-over-940000plus-fraud/news-story/7e24204c7091da5c6f32dbe81d4b2c18

[10] ASIC, 16-098MR ANZ to refund $5 million to basic account holders for incorrect late payment and overlimit fees, 30 March 2016, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-098mr-anz-to-refund-5-million-to-basic-account-holders-for-incorrect-late-payment-and-overlimit-fees/

[11] ASIC, 16-069MR Independent compliance review of ANZ's OnePath following breaches resulting in compensation of approximately $4.5 million, 15 March 2016 http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-069mr-independent-compliance-review-of-anzs-onepath-following-breaches-resulting-in-compensation-of-approximately-45-million/

[12] ASIC, 16-304MR Westpac refunds $9.2 million after failing to waive bank account fees for eligible customers, 13 September 2016, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-304mr-westpac-refunds-92-million-after-failing-to-waive-bank-account-fees-for-eligible-customers/

## 2017

In October 2016, **AMP, ANZ, CBA, NAB and Westpac** were ordered to pay more than $200 million total in refunds and interest for failing to provide general or personal financial advice to customers while charging them ongoing advice fees.[13] At 19 May 2017, they had only paid back, or offered to, $60 million or less than a third:

| Group | Compensation Paid or Offered | Still yet to be paid (excludes interest) | Total (estimate, excludes interest) |
|---|---|---|---|
| AMP | $3,816,327 | $603,387 | $4,419,714 |
| ANZ | $43,818,571 | $8,613,001 | $52,431,572 |
| CBA | $5,850,827 | $99,786,760 | $105,637,587 |
| NAB | $4,641,539 | $385,844 | $5,027,383 |
| Westpac | $2,670,479 | Not yet available | $2,670,479 |
| Total (Personal Advice Failures) | **$60,797,743** | **$109,388,992** | **$170,186,735** |
| NULIS Nominees (Australia) Ltd (1) (NAB's Trustee) | Nil | $34,720,614 | $34,720,614 |
| Total (personal and general advice failures) | **$60,797,743** | **$144,109,606** | **$204,907,349** |

**CBA** has paid back less than 6%, from the table above, despite owing the most.

**NAB's Superannuation Trustee** NULIS has yes to pay back a cent of its $34 million bill.

**ANZ** pays further $10.5 million to 160,000 superannuation customers who were affected by breaches within the OnePath group between 2013 and 2016.[14]

**ANZ** is forced to pay an additional $7.5 million to ANZ Prime Access customers for ANZ's failure to rebate commissions in line with its agreement with customers.[15]

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[13] ASIC, 17-145MR Compensation update: major financial advisory institutions continue refund programs for fees-for-no-service, 19 May 2017, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-145mr-compensation-update-major-financial-advisory-institutions-continue-refund-programs-for-fees-for-no-service/

[14] ASIC, 17-266MR ANZ pays further $10.5 million to consumers for OnePath breach, 10 August 2017, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-266mr-anz-pays-further-105-million-to-consumers-for-onepath-breach/

**CBA** pays $2.5 million to 17 customers following its use of a definition of 'heart attack' which was inconsistent with the majority of the industry. 17 claims were denied between May 2014 and March 2016.[16]

**CBA** has paid out $23 million (covering 1,641 cases and a total of $29.1m) as at 31 May 2017 in compensation to customers who lost out as a result of its poor financial advice or incorrectly imposed fees.[17]

**CBA** was forced to refund over 65,000 customers approximately $10 million, after selling them unsuitable consumer credit insurance (CCI).[18]

**CBA** was forced to refund $586,000 in premiums to around 10,000 customers after it over-insured these customers.[19]

**CBA** was forced to review its history compliance with the Superannuation Guarantee, covering 36,000 workers, which found $16.3 million owing to its workers.[20]

**CBA** reviewed 4.5 million transactions dating back to 2009, and has issued refunds totalling $5 million to around 335,000 customers.[21]

**Bankwest, a division of CBA,** refunded more than $4.9 million to about 10,800 customers after overcharging them for almost a decade.[22]

**Macquarie Equities**, has paid approximately $24.7m of compensation (including interest) to 263 clients for failing to provide advice among other breaches.[23]

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[15] ASIC, 17-145MR Compensation update: major financial advisory institutions continue refund programs for fees-for-no-service, 19 May 2017, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-145mr-compensation-update-major-financial-advisory-institutions-continue-refund-programs-for-fees-for-no-service/
[16] CommInsure Media Release, 23 March 2017, https://www.commbank.com.au/guidance/newsroom/CommInsure-notes-ASIC-report-201703.html
[17] CBA advice scandal payouts top $29m, *Herald Sun*, 16 June 2017
[18] ASIC, 17-268MR Commonwealth Bank to refund over $10 million for mis-sold consumer credit insurance, 14 August 2017, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-268mr-commonwealth-bank-to-refund-over-10-million-for-mis-sold-consumer-credit-insurance/
[19] ASIC, 17-268MR Commonwealth Bank to refund over $10 million for mis-sold consumer credit insurance, 14 August 2017, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-268mr-commonwealth-bank-to-refund-over-10-million-for-mis-sold-consumer-credit-insurance/
[20] Letts, Stephen, (15 Aug 2017), *Commonwealth Bank's ongoing systemic failures: But wait there's more*, ABC http://www.abc.net.au/news/2017-08-15/cba-updates-settlements-with-clients-and-employees/8805872
[21] *Ibid.*
[22] McCauley, D. & AAP, (2 February 2017), Bankwest refunds $5 million in mortgage interest payments, News.com.au, http://www.news.com.au/finance/business/banking/bankwest-refunds-5-million-in-mortgage-interest-payments/news-story/95995b350538a73923c36c473ffb2d36

**NAB** paid $25 million in compensation to victims of dodgy financial advice, more than $7 million of that money went to 102 customers of Cowper. NAB then allowed him to resign, gave him a farewell letter and paid him $185,000.[24]

**NAB's** superannuation trustee, NULIS Nominees (Australia) Limited (NULIS), was issued additional licence conditions following breakdowns in internal procedures. 10 members' insurance claims were incorrectly assessed with approximately $1.6 million in members' claims underpaid or declined. Approximately 400,000 members were impacted by other insurance breaches.[25]

ASIC banned former **Westpac** adviser Mr Sudhir Kumar Sinha from providing financial services until 2 June 2022 for failing to meet his ongoing advice service obligations over a period of six years while he was employed by Westpac. Westpac has paid back more than $1.4 million due to his conduct.[26]

**Westpac-owned BT** will pay $12 million to customers whose life insurance claims were knocked back, because some of these customers may not have been aware of a clause that made them ineligible to claim.[27]

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[23] ASIC, 17-177MR Macquarie Equities remediation program – update, 8 June 2017, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-177mr-macquarie-equities-remediation-program-update/

[24] Ferguson, Adele, (4 March 2017), *'I'm just a broken-down old shearer' - CBA faces grilling over CommInsure*, Sydney Morning Herald, http://www.smh.com.au/business/banking-and-finance/im-just-a-brokendown-old-shearer--cba-faces-grilling-over-comminsure-20170303-guq7qm.html

[25] ASIC, 17-022MR ASIC imposes licence conditions on NAB's superannuation trustee, 2 February 2017, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-022mr-asic-imposes-licence-conditions-on-nab-s-superannuation-trustee/

[26] ASIC, 17-178MR ASIC bans former Westpac adviser for five years, 8 June 2017, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-178mr-asic-bans-former-westpac-adviser-for-five-years/

[27] Yeates, Clancy, (14 September 2017), *BT to make $12 million 'goodwill payments' for rejected insurance claims*, Sydney Morning Herald, http://www.smh.com.au/business/banking-and-finance/bt-to-make-12-million-goodwill-payments-for-rejected-insurance-claims-20170914-gyhafb.html

**Attachment 1**

**D No.143/2015**

# ACTU Submission:

# To the Senate Economics Legislation Committee in respect of the Committee's Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015

14 OCTOBER 2015

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# INTRODUCTION

The ACTU presents its submission to the Senate Economics Legislation Committee in respect of the Committee's Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015.

The ACTU has been an important and influential participant in the development of the occupational superannuation framework which is the cornerstone of Australia's current superannuation framework. The ACTU through the Accord processes 30 years ago developed and played a major role in bringing about a framework to provide for occupational superannuation. In support of the ACTU's public policy goals, the ACTU has maintained support for the superannuation system as it has evolved over the past 30 years.

The ACTU and its affiliates remain active participants in the system. The ACTU and its affiliates have shared carriage of the maintenance of the award system upon which occupational superannuation still substantially relies. The ACTU and its affiliates also jointly sponsor, on a not for profit basis, a significant number of industry superannuation funds including some of the largest all profits to members superannuation funds in the country. The ACTU and its affiliates nominate Trustee Directors to these funds.

The principal features of the ACTU's submission are as follows:-

## Background features to the current superannuation system:-

- The current system has a unique history which, purposefully and appropriately, is part of the industrial relations environment; the system is practical, efficient and has delivered outstanding performance.

- The development and history of this system has been an important part of delivering strong public policy outcomes.

- In an overall sense, Australia has established an excellent retirement incomes system, the next stages of superannuation development means that this system will take a further step in making it amongst the best systems in the world.

- A distinct and identifiable part of the strength of this system are the all profits to members funds which are proven outperformers and are an essential part of maximising outcomes to working Australians and maintaining superannuation's role within public policy aims.

- The ACTU further submit that without the differential generated by industry fund outperformance, it is most likely that average Australian workers will not achieve the targeted measure of a comfortable income stream in retirement.

- The achievement of the overall strength of the superannuation system has come about through the development of a collaborative culture designed to maintain orderly and efficient operation of the superannuation system; this culture is supported by a well-balanced structure underpinned by equal representation and a consensus decision making framework.

- The all profits to members system has, at its heart, an approach which is designed to work in the best interests of members; other approaches which don't have this philosophy inevitably have conflict of interest issues which would mitigate against the continued delivery of the system as we know it and would open up the system to the potential of improper activity.

- The all profits to members' funds have adapted well to a changing environment. A feature of their evolution has been a trend to using Independent Directors on a selected basis to add expertise; this is a trend which should be fostered to allow it to develop within the existing culture. The funds see a danger in mandating for a large number of new Independent Directors which may change the culture, with the potential for overall detrimental impacts to the benefits the system is currently delivering

The ACTU believes the following issues are the critical issues which the Senate Committee should find that the ACTU's policy framework, as outlined below, is the appropriate approach to be taken in the construction of the Australian superannuation system's framework:-

- Supporting the current model is the surest way of continuing to provide the best public policy outcomes.

- The best policy approach to the provision of superannuation should be built around the principle that "the best interests of members" is the prime objective of the system.

- The current levels of outcome and approach depend significantly on the governance model; what is occurring is that an alternative model of governance, which has historically and structurally delivered lower outcomes, is being attempted to be imposed on the all profits to members sector without proper regard as to whether or not this will change the nature of the outcomes and approaches which are currently being delivered.

- The all profits to members system has developed a model of encouraging a sensible and selective use of Independents: one which adds to expertise, and diversity and enables the funds to hold themselves to continuing standards of performance and governance. We believe this is best done in an ordered approach, not one which simply mandates quotas.

## Commonwealth Superannuation Legislation (The CSC)

Following the release of the Exposure Draft of this legislation, the Government proposed a second schedule to the legislation which would bring about changes to the composition of the Board of the scheme covering the Commonwealth public servants and the Australian Defence Force, essentially reducing the Board from 11 persons to 9.

The ACTU believes that the composition of this board has been determined on individual circumstances reflecting the historical development of these funds – it does not have the same governance model as industry funds, with the Minister for Finance appointing the Chair and a number of Directors, and the CSC reporting to the Minister for Finance. It is inappropriate to test the governance arrangements for this scheme to the same parameter that apply to other superannuation funds.

The ACTU believes this Schedule should be separated from this legislation and dealt with through separate consideration and consultation.

# BACKGROUND TO OUR CURRENT SYSTEM

## The Historical context

- Australia's system of workforce–wide or occupational superannuation emanates from the activities of the mid-1980s when superannuation became part of the Award system. In the 1990s Award based contributions were modified and expanded, becoming the Superannuation Guarantee Charge. However, the basic elements of the distribution of superannuation has remained, being substantially regulated through the use of default funds, with the determination of these funds remaining part of the Award system. The most significant modifications of recent years are that of the recognition that superannuation should be able to be portable and that the worker should have the right to choose an alternative fund if they believe it is in their interests to do so.

- Prior to the mid-1980s, Australia commenced a national consideration as to approaches to the retirement incomes needs of its citizens. This was most notably initially considered by the Hancock enquiry which in 1976, in the light of the first analysis of prospective demographic shifts (perhaps commonly referred to as the ageing of the population), recommended in favour of a national superannuation system. This recommendation was subsequently rejected and the existing framework of corporate and Government-dominated schemes continued for some years. However, increasing criticism of a number of the design, adequacy and governance features of the corporate schemes became a first order issue of concern for legislators and public commentators by the early 1980s.

- At the same time, early steps were being taken in the industrial development of occupational superannuation – most notably in areas such as the waterfront and distribution sectors. The election of a Labor Government in 1983 saw the advent of an Accord between the Government and the ACTU; one of the aims of which was to implement occupational superannuation as part of the development of a social wage compact. An impediment to this was that the existing High Court dogma was that superannuation was not an industrial issue.

- Superannuation coverage levels for the average workforce had not improved by the mid-1980s. Still less than 40% of the workforce had access to superannuation – most coverage was still heavily confined to white collar corporate schemes and the Government sector. Coverage in blue collar areas was notable low and almost non-existent for part-time and casual workers. Women's participation in superannuation was also substantially lower than that of men. Another feature of the time was the incidence of vesting scales – so that even though a large number of workers were members of corporate schemes, they still didn't have access to any or all of employer contributions until after a prescribed period of service had been completed.

- A Building Industry dispute in 1983 was the precursor to more widespread union activity in the campaign to achieve workforce-wide occupational superannuation. The result of the dispute was an industry-wide 3% payment (or $12.50 per week) into a newly formed industry fund BUSS. Other claims of this nature emerged across other manufacturing, transport and

energy areas. In 1985 - 86, the ACTU applied to the Conciliation and Arbitration Commission to allow it to consider a case in which national productivity would be recognised through superannuation payments. The decision to recognise superannuation as an industrial issue was appealed by the Confederation of Australian Industry with the High Court upholding the Commission's decision (the Manufacturing Grocer's Case). This quickly led to the National Wage Cases of 1986 and 1987 in which the ACTU won the right for Unions to insert a provision into Awards to provide for a 3% superannuation payment to an appropriately determined fund.

- By the late 1980s occupational superannuation – fully vested, portable and preserved - was a universal right in all workplace awards.

- A detailed history of Chronology of superannuation and retirement income in Australia can be found in the Parliamentary Library Background Note, dated 1 June 2010, 2009-10.

**Superannuation is an industrial issue – it is rightly so in that it is a payment which arises as a part of a worker's employment. Codifying it in basic employment conditions – either through an Award or an Enterprise Agreement has been the normal course of events for three decades.**

**Superannuation receives the same protections as other conditions of employment. Its payment is an enforceable right for employees. The circumstances around the payment of superannuation contributions, including which fund it should be paid into, are legitimate and legally enforceable provisions which workers collectively have the right to bargain about.**

## Industry Funds – Fit for Purpose vehicles

- The advent of superannuation as an industrial condition also saw the emergence of new superannuation vehicles – industry funds. Their names are not an historical accident – they are the vehicles into which the occupational or employment based superannuation of workers in a particular industry is paid. Indeed, the Conciliation and Arbitration Commission, in the late 1980s, consistently recognised the value of having such funds as the primary recipient of occupational superannuation – in that the employer and Union participants to the industry sector were the logical groups to establish and become guardians of the funds to which occupational superannuation contributions would be paid.

- The award system also provided a practical and efficient distribution system for occupational superannuation. Unlike the superannuation schemes which existed pre-1986 which relied on the concept of a superannuation provider "selling" a corporate scheme to an employer, industry funds, working as part of the industrial system, delivered a means of workforce-wide distribution, at essentially no cost. This feature became immediately a desirable feature of the industry fund/award system including the obvious outcome that, through having lower distribution and administration costs, workers received high levels of contributions into their accumulation accounts.

- As award distribution became commonplace, so did the model of Boards of superannuation schemes being equally composed of representatives of employers and Unions. This construction is inherently "not for profit" in that it becomes the role of these bodies to be guardians of the superannuation of their workers/members and not entrepreneurs seeking to establish schemes as a profit making venture. This ethos is an important structural feature in ensuring that superannuation funds continue to act in the best interests of members.

- In the 1986 and 1987 National Wage Cases, the Conciliation and Arbitration Commission called for an orderly distribution model for occupational superannuation. The Commission recognised that workforce distribution was to be the dominant element of a new employment entitlement and saw orderly distribution – as opposed to a competitive distribution model – as being consistent with the objects of the industrial relations system in which this new entitlement was managed in such a way as to most protect it and give it most value

- In addition to joint sponsorship by employers and Unions, an important feature of the operation of industry fund Boards has been the operation of a 2/3rds majority decision making process. Rather than industry fund Boards becoming adversarial in nature in which a battle for control of the fund could have become a dominant feature, these Boards have generally developed a consensus decision making style which has further entrenched the ethos of acting in the best interests of members

- The then Federal Government also recognised the practicality and appropriateness of this outcome through the negotiation of further Accords aimed at building on to the original 3% payment. In many ways, it can be said that the Government saw the funds and their not for profit nature as a natural fit for the management of a system which should have the best interests of the participants at its heart.

## The Further Evolution of the System

Since the establishment of the occupational based superannuation system, there have been a number of developments which have built upon the principles and structure established in the 1980s. Amongst those developments the following are noteworthy:-

- The ACTU sought to increase the 3% contribution through a productivity claim in the late 1980s which the Conciliation and Arbitration Commission rejected: this led ultimately to the development of the Superannuation Guarantee Charge by the Federal Government and the phased increases in superannuation contributions from 3% to 9% over the next decade.

- Industry funds established a series of collective investment vehicles – most notably in infrastructure and property, but also across other asset classes. These vehicles allowed for an "economy of scale approach" - through the pooling of their investable funds, emerging funds gained access to a broad portfolio of investments which would not have been able to achieve of their own accord and did so at fee levels much lower than the existing practice for unlisted investment vehicles.

- Industry funds began a process of appointing Independents to Boards to add to the expertise on those Boards. One high profile appointment was Bernie Fraser, former reserve Bank Governor and Head of Treasury who served on the Boards of three funds for many years.

- Default regimes evolved somewhat with the times, initially to recognise the desire of some workers to have a model which adapted to the manner in which their working lives evolved. The model has largely remained a default fund system with a recognition that workers, as they progress through their working lives, may want to choose to remain connected to one fund rather than needing to change funds each time they took a different direction in their working lives. In more recent times this has further adapted to workers being able to choose an alternative fund as it suits their own convenience, but if no choice is made, the default regime becomes the fund into which contributions are paid.

- This development of a "public offer" regime also benefitted many contractors who, in not having a direct employment relationship, were unable to join industry funds. Industry funds, in adopting public offer status, could now accept contributions from workers who were not engaged by employers in the particular industry in which they operated.

- In recent years a new name for the "generic" product called MySuper has been introduced (as a result of the findings of the Cooper Review of the industry). This has aimed to codify a system whereby all the products offered have common characteristics (and which are low fee). This aims to bring consistency and transparency for the SGC across all potential providers of products.

- A number of legislative enhancements have occurred in recent years in order to build upon the established system. These have included a co-contribution system for low income earners, a Low Income Supplementary contribution (essentially a rebate on tax paid by low income earners) and a proposed schedule to lift the SGC rate from 9% to 12%. It should be noted the Low Income Supplement has been removed by the current Federal Government which has also legislated to defer the timetable for introduction of the increase in SGC contributions.

## Public Policy Outcomes and the Recognition of the System

- It has always been an aim of the superannuation system that it has a role in developing an adequate retirement incomes system. The Retirement Incomes system has had an objective of being a three pillar system – the Age Pension as a foundation with lesser levels of

dependence on the pension coming through occupational superannuation and the encouragement of additional private savings. Whilst it should be noted that the superannuation system is far from mature (there have only been approximately 15 years of contributions at 9%), it already shows the prospect of fulfilling its purpose of relieving widespread dependence on the Age Pension system.

- The impact superannuation has on the adequacy of outcomes for workers when they retire from the workforce is significant. One commonly used measure of adequacy in retirement is the ASFA Comfortable Standard of Retirement Income which is, at the June quarter 2005 for a single person an amount of $42,861 per annum. ASFA further calculates that the amount of lump sum needed to fund such a payment, for the life expectancy of a 65 year old male is determined to be approximately $545,000 (approximately 7 times average weekly earnings). Even at contribution rates of 12% of earnings, it is a challenge to achieve this outcome, requiring consistently high investment returns. It is therefore critical to the achievement of good public policy outcomes that the superannuation system be as effective and efficient as it can be. That effectiveness, in the ACTU's submission, is best achieved in having a superannuation system where maximising the level of returns is a core aim.[1]

- The effectiveness of achieving these aims also has a natural corollary in what happens to public outlays on the pension system in years to come. Clearly if the superannuation system underachieves, there is a greater reliance by workers on the Age Pension; conversely if the superannuation system achieves the maximum outcomes it can, pressure on financing the Age Pension is relieved.

- Australia has a high recognition for its retirement savings system. The recently published Mercer Global Pension Index for 2014 rated Australia the second best system in the world, but rated it at a level which said it was "A system that has sound structure, with many good features, but has some areas for improvement that differentiates it from an A-grade system". A feature of Australia's recent improvement in its rating within this Index has been the legislated increases which will raise the SGC from 9% to 12%. Also underlying the health of our rating has been the strong performance of the superannuation component and, in the ACTU's submission, any threat to the performance of that system would have an impact on the strength of our overall rating.[2]

- The ACTU submits that a key feature of the success of our system and its ability to deliver an optimal public policy outcome has been the ability to maximise performance, and particularly investment performance. Our submission details some more information in relation to this situation under the section Industry Super - The Outperformance Story.

[1] ASFA Retirement Standard www.superguru.com.au
[2] Melbourne Mercer Global Pension Index www.globalpensionindex.com/overall-index-results/

# INDUSTRY SUPER THE OUTPERFORMANCE STORY

Industry Superannuation funds have asserted for some time there is a performance differential between themselves and retail superannuation funds. The assertion traditionally relies on two basic features. These features can commonly be referred to as the owner dividend and the infrastructure imbalance.

The first issue (the owner dividend) says that all things being equal (that is industry funds and retail funds achieve the same gross return), retail funds have a structural disadvantage in that they need to return part of the gross return to the owners of the fund. Industry funds, as all profits to members funds, do not have this structural disadvantage.

The second issue (the infrastructure imbalance) says that industry funds have moved away from the traditional "defensive" components of asset allocation (being a large allocation to bonds) towards an allocation to infrastructure assets which it is claimed have the same defensive qualities but are linked to the performance of major operational activities.

This summary, relying on the Quarterly Superannuation Performance Statistics published by APRA (the latest version being June 2015) and published industry data, seeks to further analyse these assertions.

## Performance Data

APRA performance data shows the following history of performance:-

Five Year average annualised rate of return:-

| Year Ending | Industry Funds | Retail Funds |
|---|---|---|
| June 10 | 3.8 | 2.1 |
| June 11 | 2.7 | 1.0 |
| June 12 | -0.2 | -1.7 |
| June 13 | 3.8 | 3.0 |
| June 14 | 9.1 | 7.8 |
| June 15 | 9.2 | 7.5 |

Source: APRA Statistics Quarterly Superannuation Performance, June 2015 (issued 20 Aug 2015)

The outperformance data supports a hypothesis that industry funds continually and consistently outperform their retail equivalents.

These findings are also supported by modelling undertaken by Industry Superannuation Australia, which has relied on published data from SuperRatings. That information is available on the ISA website at Industrysuper.com/assumptions. An example of how this modelling can be interpreted in a practical sense can be seen in Attachment 1, a document prepared by Australian Super based on the SuperRatings Fund Crediting Rate Survey – SR50 Balanced Index – June 2015.

Whilst there is no available data on the dividend retail funds deliver to their owners, the ACTU submits that the fact that such a dividend exists empirically supports a conclusion which can be drawn from the historical data – that retail funds consistently underperform industry fund.

## Asset Allocation

The APRA performance data from June 2015 shows the following data in respect of average asset allocation for industry funds and retail funds:-

Asset Allocation as at June 2015

| | Industry Funds | Retail Funds |
|---|---|---|
| Cash | 11% | 15% |
| Fixed Income | 15% | 20% |
| Equity | 53% | 56% |
| Property | 10% | 5% |
| Infrastructure | 7% | 1% |
| Other | 4% | 3% |

The Asset Allocation data also support the hypothesis that there is a structural difference in the approach to investing between industry funds and retail funds. Industry information says that the typical returns of assets classes for the year ended 2015 were as follows:-

| | One Year Return | Three Year Return (Annualised) |
|---|---|---|
| Cash | 2.6% | 2.9% |
| Global Bonds | 5.6% | 6.0% |
| Australian Bonds | 5.6% | 4.8% |
| Property | 10.0% | 9.0% |
| Infrastructure | 6.9% | 9.3% |
| | | |

(See attachment 2 - Asset Class Index Returns)

Whilst investment performance fluctuates from year to year, the returns of asset classes are broadly in line with current long term expectations. In a simple analysis of these asset allocations and returns, it is the case that if you have 10% more of your allocation in asset classes which are producing investment returns which are some 5% higher, then you establish a case for sustained outperformance. Given there is a lengthy history of outperformance, the ACTU says it is reasonable to look at these long term asset allocation and performance differentials as a key contributor to the outperformance story.

Clearly there needs to be some case taken of the risk associated with investing in different asset classes. In practice, the outperformance story is now one which has been in place for such a length of time, that it is reasonable to say that the volatility in returns which would normally occur if there was a significant risk issue, simply has not occurred.

The question might be asked as to whether these imbalances might be easily corrected by retail funds amending their asset allocations. However, the issue is not as straightforward as this.

Retail funds currently have a similar cost base as compared to industry funds. The ACTU believes this arises from the desire to be able to promote the MySuper products of retail funds as cost competitive to that of industry funds.

However, to be able to do this, the ACTU submits that it is necessary for retail funds to focus on “low cost” asset classes. The outworking of using these “low cost” asset classes has been a performance differential in comparison to the performance of industry funds.

For retail funds to change asset allocation to have higher exposures to infrastructure and property, the ACTU estimates this would add over 30% to the cost basis for retail funds (see attachment 3).

The ACTU submits that retail funds area caught in a difficulty of their own making. In an effort to maintain competitive costs, they are constrained in asset allocation to constructing portfolios which inherently underperform. Conversely, if they sought to change these portfolios to match industry fund performance outcomes, they would face substantial increases in their cost base.

## The Impact of Outperformance

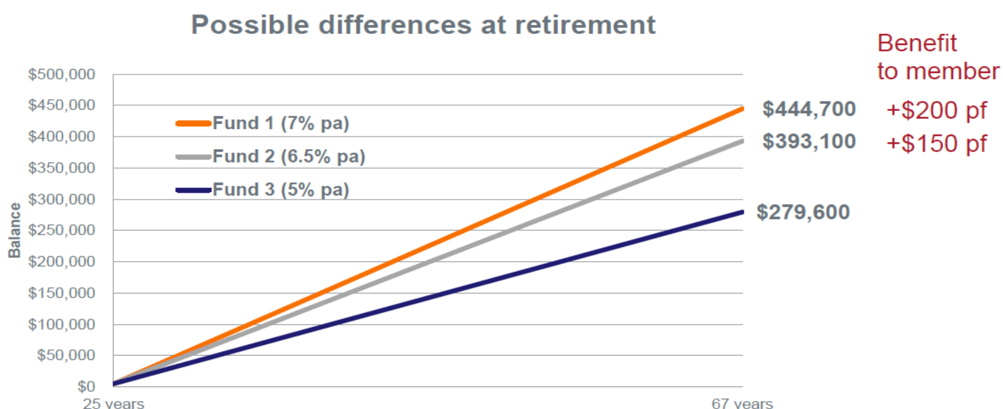
The ACTU relies on a number of references to detail the impact of the differences which occurred if Outperformance is sustained over a longer period:

1. Australian Super and “The difference a few percent can make…”

   Australian Super has modelled the impact of outperformance in the difference between investment returns of approximately 7% pa and 5% pa over the working life of average workers.

This modelling is shown below:

**The difference a few percent can make…**




Source: Internal AustralianSuper calculations. Member aged 25 at 30 June 2015, retiring at age 67, Account balance at age 25 = $5,000, Salary at age 25 = $50,000, assumed to increase year at 3.5% pa, Employer contributions are 9.5% initially, rising to 12% in line with legislated increases, Investment returns after fees and taxes are: 6.5% pa (Fund 1) and 5.0% pa (Fund 2), Assume AustralianSuper admin fees of $1.50 per member per week for both Funds, The account balance at age 67 is shown in today's dollars by discounting at 3.5% pa.

1 *Level income to be received from the super account and Age Pension combined over 25 years from retirement, Investment returns in retirement after fees and taxes of 5.5% pa, Assume AustralianSuper Choice Income admin fees of $1.50 per member per week plus 0.11% of account balance (max $750pa), For Age Pension purposes we assume: Member is a single, homeowner, Age Pension rate as at 30 June 2015, increasing in line with average earnings of 3.5% pa, Assets test thresholds that will apply from 1 January 2017, all assets test and income tests thresholds increase in line with CPI of 2.5% pa*
*Income figures in today's dollars by discounting at 3.5% pa*

Most notable from this modelling are the following features:

- Australian Super shows the projected outcome over a 42 year investment period with a 7% pa return as being $444,700. Over time this figure would be higher if 12% contributions were payable over an entire working life; notwithstanding this, the current projection is still some $100,000 less than the ASFA Comfortable Standard of $545,000.

- Given returns of some 2% less pa for retail funds, the projected benefit of $279,600 is significantly less than the ASFA Comfortable Standard – being just over 50% of this Standard.

- The impact on retirement income streams between the projection of a 7% pa return versus a 5% pa return equates to a difference of $200 per fortnight in retirement income.

2. Industry Super Australia has modelled differences in potential lump sum benefits based on 10 year averages in the return achieved by the average industry fund and the average retail fund. A summary of a different outcomes is as follows:-

| | Age at commencement | Starting Account Balance | Net Income | Average Retail Master Trust at age 65* | Average Industry Super Fund at age 65* |
|---|---|---|---|---|---|
| Electrical workers | 40 | 50,000 | 58,000 | 281,372 | 328,789 |
| Professionals | 45 | 110,000 | 130,000 | 486,461 | 552,012 |
| Inspectors | 30 | 46,333 | 47,000 | 384,125 | 468,195 |
| Hospitality workers | 25 | 4,400 | 23,000 | 169,033 | 204,076 |

* These comparisons assume that historical levels of the difference in performance between Industry Funds and Retail Funds is maintained.

(See attachment 4 – Compare the pair leaflets as prepared by Industry Super Australia)

The ACTU submits that this evidence tells a story of a strong system, but still somewhat short of the adequacy levels the ACTU would aspire to. The ACTU's conclusion on this evidence is that the only prospect of approaching these levels adequacy is through the level of performance being achieved by industry funds. If we were forced to rely on the levels of investment performance generated by retail funds, Australia has no real prospect of achieving the adequacy levels described in this section.

## Investing in the National Interest

Another feature of the investment industry funds investment profile is its investment in infrastructure – being seen as investing in the national interest. The APRA statistics show a total industry fund infrastructure investment of approximately $30.24billion (being 7% of a total asset base of $433billion). Retail funds invest approximately $5.35billion in infrastructure (being 1% of a total asset base of $535 billion), albeit it is acknowledged that some of the infrastructure spending for both retail and industry funds is in offshore assets.

The projected growth of industry funds will see both a greater proportion and a greater absolute amount of the nation's superannuation savings invested in areas like infrastructure.

## DIFFERENTIATING INDUSTRY FUNDS FROM INSTITUTIONAL OR RETAIL FUNDS

Industry funds, throughout their history, have differentiated themselves from Institutional or Retail funds in a number of different aspects. In this submission, the ACTU highlights some of these key differences and why this differentiation has been to the benefit of Australian workers.

- The key differentiation is the difference between for profit funds (being the retail funds) and all profits to members funds (being the industry funds).

- At its base level this difference is as simple as saying that for profit funds require the retention a certain amount of earnings of the fund to pay a dividend to the owners of the funds. Hence the level of return to the participating worker in such a fund is reduced by the amount of the dividend which is paid to the owners of the fund.

- The reasons why any financial system might be operated by for profit organisations rather than by all profits to members organisations would be that there is an inability in structure or resources within the all profits to members organisations, that the for profits organisations can offer a higher level of service or can operate more cost efficiently than all profits to members organisations.

- Fundamental to the issue of what should be the delivery approach (that is through for profits, all profits to members or a hybrid) is the fact that the superannuation system is essentially a mandated piece of public policy. The question which emerges from such a situation is whether the Government should endorse a system in which part of the potential superannuation savings is used to pay the operations of retail organisations (whether this be through a sales commission or through a dividend to the owners of those organisations). The ACTU submits this should only be countenanced in situations where there was an inability to provide the service or where there was a demonstrable case that better outcomes would be achieved through such an approach. The ACTU further submits there is no credible evidence which supports the assertion that a better outcome would be achieved.

- The development of the MySuper regime has consolidated the position that the superannuation product offered to workers is essentially homogeneous across the range of providers. Whilst there can be differences in elements of the product in areas such as the charges made, the level and charge of insurance and the investment return – the MySuper products of all providers are now all relatively close in their features. The public transparency which attaches to MySuper products means there is very little scope for difference in key features. The general evidence in the sector is that cost structures are generally quite low and the increased presence of retail funds in the provision of occupational superannuation in the past decade or so has not led to any evidence that these funds can be more efficient in their operations than industry funds.

- Notwithstanding this, it is important to note that industry funds, throughout the period in which APRA has maintained records, have outperformed retail funds.

- A concern the ACTU has in the greater opening up of the superannuation system is that cross-selling or up-selling will become a feature of the way in which retail organisations attempt to gain market share. Most of the organisations which back retail superannuation funds are multi-faceted organisations which in addition to superannuation, offer banking, insurance and other financial products. The concern the ACTU has in this area is that the retail organisations will seek to convince employers to move the default fund status applying to that employer to a fund operated by the retail organisation and this will occur through the provision of discounts or advantageous access to other products the retail organisation offers. The ACTU is concerned about this potential development in that these inducements will lead to workers being defaulted into superannuation funds which are inferior to the respective industry fund – workers will receive lower returns and have lower net balances whilst retail financial organisations essentially use the differential in returns to pay dividends to their owners.

- Notwithstanding reported proposed attempts by the Government to regulate these approaches, in almost all cases there will be individual dealings between an intermediary and an employer with the intermediary having a range of pricing points to offer the employer – a situation which is essentially impossible to regulate.

- It is also noted that the nature of super is that there are low levels of engagement in respect of issues like fund choice. This level of engagement often means that workers are unaware of the detail involved in areas like asset allocation and performance reporting. The impact of long term underperformance is one many workers will only find out many years later when they realise that being defaulted into an underperforming fund was against their interests.

- A feature of the retail sector, in recent years, has also been the propensity of those organisations to be involved in "financial scandals". A number of those scandals are referred to below, but suffice to say a common feature of the scandals has been the linkage of conflicted remuneration arrangements between the "sellers" of the products in that, in almost all cases, inferior or substandard products or investments have been offered to investors mainly because the intermediaries of the for profit organisations had been incentivised to sell those products. And in many case, it can also be said that the products being sold were not in the best interests of the investor, but appear to have been in the interests of the intermediary or the institution.

- The three most significant scandals of recent times have been the operations of three groups – Westpoint[3], Storm[4] and Trio[5]. All have involved either some form of channelling of investors' funds through financial advisers or the mis-investment of significant amounts of self-managed superannuation accounts. The major retail institutions have been variously involved in the scandals and have essentially had either their clients referred to the

[3] http://asic.gov.au/about-asic/media-centre/key-matters/westpoint/
[4] www.storm.asic.gov.au
[5] http://www.google.com.au/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=2&ved=0CCMQFjABahUKEwiW79eJyb7IAhXh2qYKHYjlAKw&url=http%3A%2F%2Fwww.aph.gov.au%2F~%2Fmedia%2Fwopapub%2Fsenate%2Fcommittee%2Fcorporations_ctte%2Fcompleted_inquiries%2F2010_13%2Ftrio%2Freport%2Fb02_pdf.ashx&usg=AFQjCNH0zsfPILenjdN2_x1_GwjcIHUzlw

advisers/investors or were involved in lending schemes and margin calls which precipitated the collapse of the investment houses. Regulation of the Companies did not assist in protecting the interests of many of the investors involved in the collapses. What is most relevant to the cases is that they are examples of what occurs when there is a mis-alignment of the interests of the investors and those selling superannuation/investment schemes. That mis-alignment does not occur in the framework for occupational superannuation. Within industry funds where there is an orderly approach to distribution and there are no sales agents as such and hence, no incentivisation to grow business for growths sake.

- In all of the financial scandals referred to above, Independent Directors sat on the Boards of all the institutions which had involvement in the scandals. This is not to say the Independents were corrupt or inept, but it is to say that having Independents within a system is not a guarantee to avoid scandals and significant loss of workers' money. Mandating Independents, as proposed to do in this Bill, will not automatically provide a governance regime which is better than what exists – in the ACTU's submission, it is how the governance regime is managed within the culture of superannuation organisations which is the best test in determining the security of workers superannuation savings.

- Whilst a change to the default system would be the principal factor which would cause a substantial shift in the provision of superannuation away from industry funds to retail funds, the ACTU also submits there are issues within the proposed Governance changes which would have the same impact. These issues include the following:

    - That the explicit aims of the legislation is to make industry fund Boards change their structure;

    - That further aims of the legislation are to remove requirements for equal representation and the two-thirds majority requirements for the decision making;

    - These changes, both implicitly and explicitly, could have consequential changes to the nature of industry funds. They could lead to industry funds beginning to resemble the operational platform of retail funds either by these changes in the structure or by the control of decisions being dominated by a class of Independent Directors with a set of allegiances which are not necessarily solely determined as being in the best interests of members.

## SUMMARY OF THE KEY FEATURES OF THE SUCCESS OF THE OCCUPATIONAL SUPERANNUATION SYSTEM

- A low cost to members system delivered through the Award system (and not through a traditional sales/marketing approach).
- High standards of governance, behaviour and performance given the important role the system has played in formulating the nation's retirement incomes policy and structure.
- A best interests to members approach which continues to define the approach through collaborative structures rather than competitive ones.
- A collective approach to investments which has reduced investment expenses and delivered sustained investment outperformance.
- An all profit to members network of funds all aligned to similar goals for the system, enhanced through structures involving equal representation Boards with 2/3rds majority voting requirement.
- A selective use of Independents to add to expertise but not detract from governance structures.
- Avoidance of the institutional approach which have distribution and investment regimes associated with the remuneration structures of sales agents which potentially lead to conflict of interest: sometimes those conflicts are managed, sometimes they are not.

## SIGNIFICANT ISSUES TO WHICH THE ACTU WISHES TO BRING TO THE COMMITTEE'S ATTENTION

1. The current model is a proven success and a key part of the nation's retirement income system. Supporting the structures which have made this system successful is endorsement of the success of the current model and its key features – low cost and high outcome.

   - The success of the system comes in part from the manner in which it evolved and the high levels of performance it has generated. That performance is a critical part of the aim of building a world class retirement incomes system. And within the development of this system, industry funds have differentiated themselves from retail funds by producing a level of outperformance which is equally as structurally important to the delivery of the best possible outcomes.

   - These features are not by accident – they are built from a culture which has built and maintained these structures.

   - Maintaining that culture is a key ingredient to continued success.

2. A motivation which should drive the outcome of this Inquiry is "What is in the best interests of the users of the system – the nation's superannuation and pension fund members?". The ACTU's submission is that the best interest of member's is aligned to a fund structure which is best placed to serve those interests.

   - Alternative models do not guarantee the best interest of members as the sole aim of the scheme; in fact by definition, retail models inherently have other interests to serve – in particular the need to pay a dividend to the owners of the retail organisations.

   - In addition, changing the model to a retail focus also introduces the need for a sales/marketing structure (which is one of the most cost intensive parts of a distribution system). The recent history of sales structures in financial services is that it adds a conflict of interest issue – the interests of the agent become a factor, the interests of the selling organisation become a factor. This also heightens the risk of financial scandal.

3. There are essentially two approaches to building organisations and funds to be core infrastructure of the superannuation system. One is through the all profits to members approach – collaboratively oriented Boards which have delivered high levels of performance. The other is through a for profit system - competitively oriented Boards which have lower levels of performance. The aim of the legislation can be summarised as trying to make the Boards of the all profits to members Boards act and operate more like the Boards of the for profit organisations: the conclusion from this is if the Boards start to operate this way, then the performance of the funds will also start to resemble the performance of the funds operated by the for profit Boards.

- The linkage between performance and Board/organisational culture is not an accident. Organisational culture in industry funds has driven efficiencies through a collaborative distribution model; it has also delivered high performing collective investment vehicles which have facilitated collaborative bidding on a substantial number of Australian assets and have delivered the benefit of the ownership of those assets across many funds and fund members.

- Changing Board structures ultimately leads to a change in Board focus – in industry funds, this is the delivery of the best superannuation outcome for that member, with that outcome ultimately delivered by working collaboratively with other parts of the entire superannuation system. Changing superannuation culture would mean inevitable all Boards would have a sole focus of maximising the success of the individual fund, which will inevitably promote the development of a competitive culture, aimed at out-marketing and outperforming other funds and not working in collaboration with them.

- The ACTU believes this will also impact on the commitment to the collective investment process which partly owes its success for the reasons explicitly stated in their name – the funds, collectively support them. The more diverse Trustee Boards are and the more their motivation changes, the less support there will be for collective investment and in turn the opportunity to participate in the collective ownership of large scale assets, like infrastructure. This also weakens the pre-conditions which have underpinned the outperformance achieved by these vehicles.

- Almost the worst outcome which could be imagined would be the loss of a vibrant all profits to members sector: its culture is not a guaranteed outcome, in many cases, the not for profit structure is not enshrined in Company constitutions or those constitutions could be varied to change to the all profits to members principle - the only reason the culture exists is because it is structurally held together through issues like equal representation and 2/3rds majority principles. Mandating a traditional for profits Board structure on to the industry funds may well cause a change in the existing culture and an evolution away from the all profits to member culture and eventually all funds operating on a retail-style platform.

4. Adding Independents to a Board should be a carefully managed process to ensure the fit and culture of the Board is maintained. It should be supported by not weakening the fundamental structural features which have made Boards successful – namely equal representation and 2/3rds majority voting rules. Mandating Board structures to having 1/3rd of its Directors as Independents or 50% of its Directors as Independents on an “if not, why not” introduces new cultures which, in a traditional for profit sense, will concentrate on issues such as market share, fund growth and ultimately profit share.

    - Industry funds have been successful in introducing Independent Directors to their operations in a judicious, diverse and rational manner – adding expertise for specific reasons when needed and maintaining the balance and structure within funds.

- The danger with 1/3rd, 1/3rd, 1/3rd structures, when combined with changes to equal representation and removal of majority voting rules, is that this creates a climate where a group of Independents can vote en-bloc with a group of Directors ultimately resulting in a recipe for the break-down of Board harmony.

- Adding a large number of Independent Directors simply for the sake of appearance is a process which becomes difficult in itself to manage and is more likely to destabilise the culture of funds than a process of gradual introduction of Independents, on a needs basis.

- A much sounder process is to encourage greater expertise as an aim of the system and allow funds to work to established timeframes to achieve this aim and maintain their culture.

For these reasons, the ACTU urges the Inquiry to come to the conclusion that the proposed legislation does not have merit and should not be proceeded with.

## Commonwealth Superannuation Legislation

The ACTU is not necessarily adverse to decreasing the size of the CSC Board and we note the separate submission of the Community and Public Sector Union on this issue which sees the reduction of this Board as a separate issue to the other issues raised in legislation.

# APPENDIX

## The ACTU's Response to Other issues

The ACTU has struggled to find a clear reasoning as to why the proposed changes might be proceeded with.

Our understanding of the principal reasoning the Government has advanced is the following:-

1. **It will bring a better level of expertise and governance to funds.**

## On Investment, the ACTU says the following:-

1. We agree that there will be Independent Directors with a skill set which would be useful in assisting in overviewing the Investment function within funds. This function is already both a complex and professional function of fund operation.

2. Most large funds already operate with the support of both Investment Advisors and internal investment staff. The larger the Funds, the more substantial the internal investment staff numbers and influence will be. For example, the largest industry fund, Australian Super, has in excess of 100 internal investment professionals and is expanding this number as it undertakes more investment functions internally. Staffing of this nature includes experienced heads of assets classes, specialist asset allocation staff, macro-economic staff and the like.

3. In all of these cases, investment recommendation are initially prepared by internal staff and/or Investment Advisers. The additional of specialist members of Investment Committees and Board has been used to enable credible analysis of recommendations. The question is whether mandating a set number of Independents will change or improve this process.

4. At one level it can be argued that the current outperformance of industry funds reflects that the current model is working highly efficiently.

   Further, a concern raised by commentators is that changing the model to a model dominated by Independents is actually likely to harm performance (in that Independent-dominated models tend to more slavishly follow institutional advice – and this is the model which has historically and consistently underperformed the industry fund model) – see the Alan Kohler Opinion Piece of 25 July 2015. (See attachment 5)

## On Governance, the ACTU says the following:-

1. The industry fund sector is highly regulated by APRA. Apart from Fund level assessments, APRA undertakes biennial Board assessments whereby it meets with the full Board of each Fund and expects the Fund Directors to take APRA through the rationale and impact of major decision, policies and approaches. This is a process which has occurred for several years now and gives APRA a close insight into the competence of Boards and an ability to comment, positively or critically, on any aspect of a Board's operations.

2. We are unaware of any cases in which APRA has been critical of governance arrangements. On the converse, we have been advised of many reports by APRA in which they have been completely satisfied of the competence and functioning of Boards.

3. APRA has extensive powers in this area. It can require Boards to meet high standards; it can revoke licences in the case of underperforming or dysfunctional Boards. This is a process that has been used from time to time and has proved to be an appropriate and adequate remedy to governance issues.

4. On this basis, the ACTU submits there is no need for a radical approach to fix a problem which we say, simply, does not exist.

**2. Changes in fund structure and operation will bring a level of competition in which the consumer will benefit**

The ACTU believes there is no credible case to support this assertion for the following reasons.

1. Retail funds have operated as alternatives to industry funds for a number of years now and in recent years retail funds have heavily marketed themselves as alternative choices for the occupational superannuation contributions for workers. In addition, MySuper has led to transparent disclosure of the cost structures underpinning fund administration.

2. There is no evidence, nor claim by the industry, that there will be a reduction in administration costs through a widening of competition in the industry. In fact, the situation is that more competition will add to costs in the sector in that it will bring about the following changes:-

    - It will fundamentally change the manner of superannuation distribution from a structured Award system in which a default fund system operates to one characterised by the selling of superannuation with a greater emphasis on a retail selling system. The selling of superannuation to employers in itself creates a conflict in that a sales relationship is not the natural relationship for managing an entitlement which from time to time requires an enforcement regime to support it. Seeking to enforce an entitlement in an atmosphere where the employer/provider relationship is built on a different foundation is inappropriate and unworkable.

- It will add the costs of selling to the cost of administration. Currently superannuation basically exists in a no cost distribution environment; changing this nature to a competitive sales environment in which all funds will need to employ specialist sales staff or other specialist staff to overview other distribution methods – online, direct marketing, social media or the like. In any case, marketing costs across the industry would also rise significantly. In the end, the person who pays for these additional costs is the fund member.

- Selling structures also introduce conflict of interest issues in that the sales person's approach will be to deliver an outcome which is primarily in their own best interest as opposed to what might be the best interest of the worker. For instance, this might be particularly relevant to when a superannuation fund member wishes to make a change to their investment choices, and that choice might be an asset class which has lower investment expense fee associated with it – will a sales person advise the member as to what is the member's or the sales person's interests?

In respect of investment performance, again there is no evidence that changing a governance or an operational model will produce better outcomes. The most striking rebuttal of this claim is that retail funds have historically and consistently underperformed industry funds. The outcome of such underperformance, if maintained over the long term, are significant shortfalls in end benefits and an increased likelihood that the broad social aims of achieving a comfortable standard in retirement will not be met.

Whilst these responses are more appropriately reflective of a substitution of a retail fund for an industry fund, they also appropriately apply to this situation in that an aim of the legislation is essentially to make industry funds look more like and act more like retail funds.

3. **The defence is about Unions protecting a privileged position.**

   The union movement has a proud track record in its participation in the Occupational Superannuation system. In addition to contributing to acknowledged enhancement to public policy. The guardianship of funds has operated in a not for profit environment which has outperformed comparable retail funds.

   During its 30 year history, the ACTU has supported fund mergers where these mergers have been supported by sponsoring organisations and are in the interests of fund members.

   This public position is one the ACTU continues to maintain and advocate in favour. The ACTU is unaware of specific instances where these principles have not been followed in both spirit and in actual outcome.

4. The Governments Explanatory Memorandum essentially says "the proposed changes will enhance governance, consistent with the views of the Financial Systems Inquiry (FSI) the Murray Review and the Cooper Review, in that, inter alia, they will lead to:

- A potential benefit through increased performance;
- Bringing good features of governance into the system through "independence of mind" and a "diversity of world view" and an ability to ask the right question;
- Less conflict (in that Independents will be free of conflicted issues);
- Consistency with international outcomes.

The ACTU's submission is that the findings of both the Cooper and Murray reviews is that were both inadequate in understanding industry issues proposing a mandated response.

For instance, the claims that outperformance could be achieved are, effectively, unsubstantiated. And the performance of the sector against both peers and in international terms was noticeably unreported.

Indeed the historical outperformances of the industry fund sector, had it been appropriately analysed, would show high levels of competence and expertise.

This issue is a critical issue in examining the other aspects of Cooper and Murray. If it is accepted that they misidentify this outcome, then it is basically redundant to say that simplistic fixes will help improve (a misidentified) problem.

Indeed the ACTU's submission is that the proper finding for both Cooper and Murray is that performance is not a problem and that significant structural changes are not needed (and may even be detrimental) to continue outperformance.

In respect of governance issues, the ACTU's reiterates its views, essentially, as follows:

- There are no identifiable governance issues which are causing problems (to a highly credentialed, well performing sector);
- This is confirmed through the real absence of intervention by APRA in its regular review and appraisal of the sector;
- The real danger to our system is to mandate changes which may affect a successful culture which has performed to high standards in both the interests of Australian workers and Australian public policy.

## ATTACHMENTS

1. Investment performance (to June 2015)
2. Asset Class Index Returns
3. ACTU Calculations on the cost of moving 10% of assets from Bonds to Infrastructure/Property (bases upon information extracted from APRA Quarterly Statistics)
4. Compare the pair
5. Alan Kohler Opinion piece, 25 July 2015

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**D No: 143/2015**

Australian
Unions
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better life.

#1

# Investment performance (to June 2015)

% pa

12%
10%
8%
6%
4%
2%
0%

AustralianSuper Balanced
Median not-for-profit fund
Median Master Trust

10.86%
9.70%
9.28%
1 year

7.30%
6.70%
5.14%
10 year

**Source:** SuperRatings Fund Crediting Rate Survey - SR50 Balanced Index - June 2015
10 year returns are average annual returns
Past performance is not a reliable indicator of future returns.

1 October 2015

Mr Bernie Dean
Director of Marketing
Industry Super Australia
Level 39, Casselden
2 Lonsdale Street
Melbourne VIC 3000

Dear Bernie,

**SUPERrater tool and Net Benefit Modelling**

This letter provides Industry Super Australia ("ISA") and its collective of 15 superannuation funds ("the ISA funds") with confirmation of the ability to rely on the Net Benefit Modelling and SUPERrater tool developed by SuperRatings Pty Limited ("SuperRatings").

SuperRatings developed the Net Benefit Modelling tool with the assistance of ISA to compare the outcomes of the ISA funds against that of Retail Master Trusts over periods ranging from 1 to 10 years, utilising a range of salary and account balance assumptions. Returns for this model have been updated for the period ended 30 June 2015. SuperRatings sample set of Retail Master Trusts consists of 85 Retail Master Trusts that are tracked by SuperRatings and have a 10 year performance history as at 30 June 2015.

In addition, the SUPERrater tool was also developed by SuperRatings in conjunction with ISA to graphically model the net benefit outcomes of the median of the ISA funds against that of the median Retail Master Trust over a 10 year period. These tools were thoroughly reviewed both internally by SuperRatings and ISA to ensure the methodology and calculations were correct.

Subsequently, the SUPERrater tool was offered to each of the ISA funds to model their individual fund outcomes against the Retail Master Trust median, based upon their own salary and account balance assumptions.

Whilst the Net Benefit Model was originally developed to allow the comparison of the median of the ISA funds against the Retail Master Trust median utilising a range of assumptions, we can confirm that both ISA and the individual ISA funds can rely on the methodology and outcomes that have been produced by the model. We also confirm that the outcomes have been correctly reflected within the SUPERrater tool and that these can also be relied upon as accurate by both ISA and the individual ISA funds that have subscribed to the tool.

We trust that this information is sufficient for the purposes required and would be happy to discuss this further.

Should you have any questions regarding the above, please do not hesitate to contact Wendy Tse or me on (02) 9247 4711 or via e-mail at wendy.tse@superratings.com.au or adam.gee@superratings.com.au.

Yours sincerely

Adam Gee
*Chief Executive Officer*

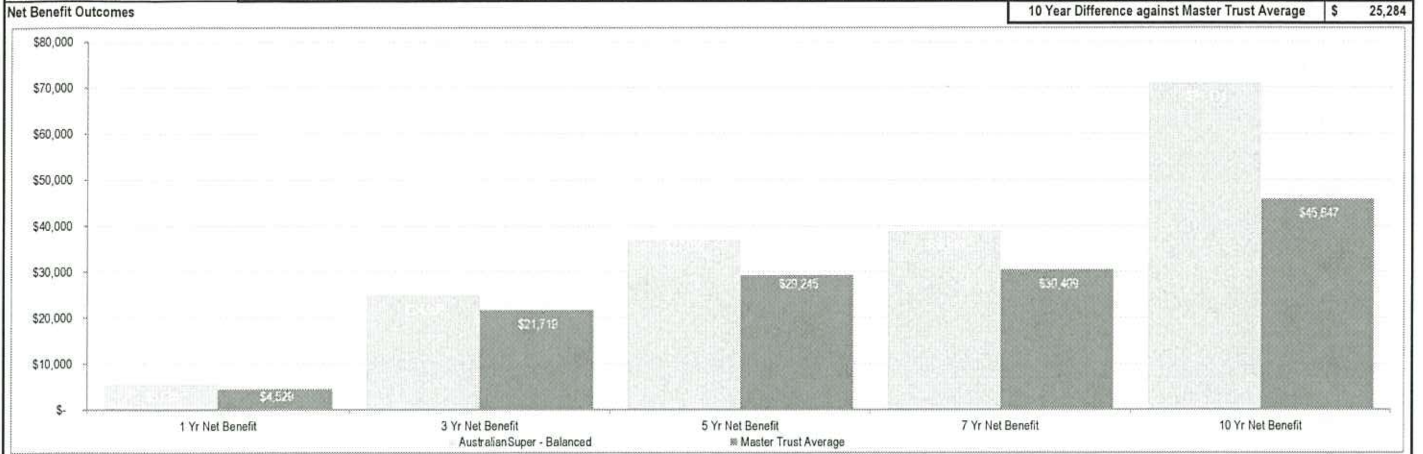
## Net Benefit Modelling Outcomes

| Starting Salary | $ | 50,000 | As at | 30/06/2015 |
|---|---|---|---|---|
| Starting Balance | $ | 50,000 | Prepared | 28/09/2015 |

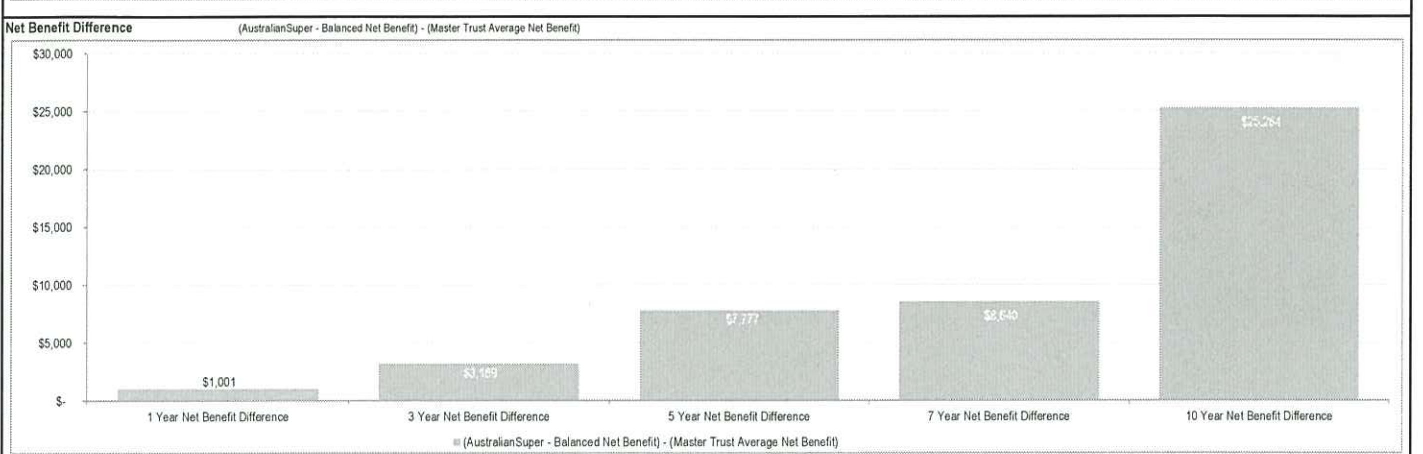
| Rated Option | Earnings | Fees | 1 Yr Net Benefit | Earnings | Fees | 3 Yr Net Benefit | Earnings | Fees | 5 Yr Net Benefit | Earnings | Fees | 7 Yr Net Benefit | Earnings | Fees | 10 Yr Net Benefit |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| AustralianSuper - Balanced | $ 5,890 | $ 360 | $ 5,530 | $ 26,285 | $ 1,377 | $ 24,908 | $ 39,549 | $ 2,527 | $ 37,022 | $ 42,555 | $ 3,605 | $ 38,949 | $ 77,474 | $ 6,344 | $ 71,131 |
| Master Trust Average | $ 5,421 | $ 892 | $ 4,529 | $ 25,280 | $ 3,381 | $ 21,719 | $ 35,851 | $ 6,606 | $ 29,245 | $ 40,027 | $ 9,617 | $ 30,409 | $ 62,947 | $ 17,100 | $ 45,847 |

**Net Benefit Outcomes**

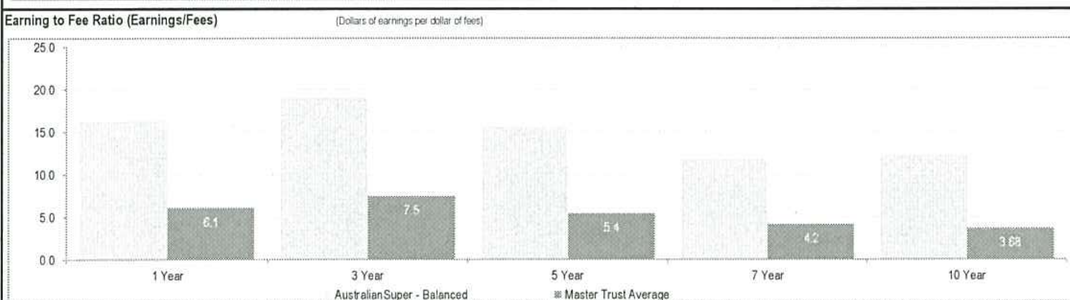
10 Year Difference against Master Trust Average: $ 25,284




**Net Benefit Difference** (AustralianSuper - Balanced Net Benefit) - (Master Trust Average Net Benefit)



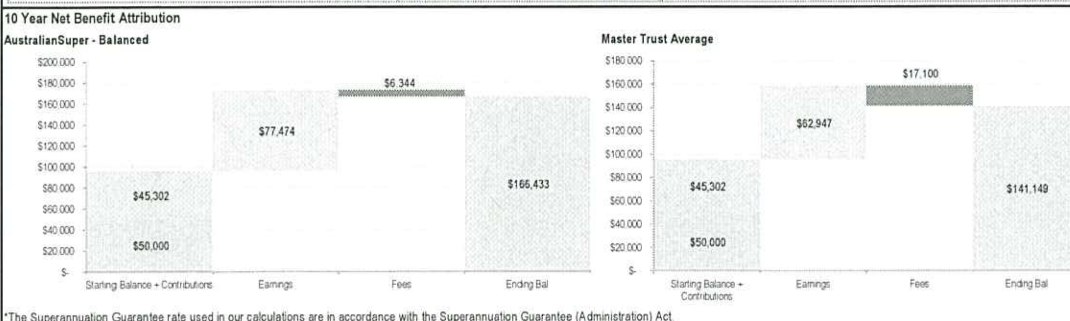

**Earning to Fee Ratio (Earnings/Fees)** (Dollars of earnings per dollar of fees)




**Assumptions**

| | | |
|---|---|---|
| Annual Inflation Rate | | 2.50% |
| Wage Increase Rate | | 3.50% |
| Wage Deflation Rate | | 0.00% |
| Acc Bal Deflation Rate | | 0.00% |
| Super Guarantee Rate* | | 9.50% |
| Contribution Tax | | 15.00% |
| Wage Increase Rate | | 3.50% |
| Salary | $ | 50,000 |
| Annual Contributions | $ | 4,500 |
| Starting Balance | $ | 50,000 |

**10 Year Net Benefit Attribution**




SUPER RATINGS

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*The Superannuation Guarantee rate used in our calculations are in accordance with the Superannuation Guarantee (Administration) Act.

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 # Attachment 2

# Memorandum

**Date:** 9 October 2015

**To:** Brian Daley

**From:** Daniel Craine, Head of Performance, Risk and Options

Level 33, 50 Lonsdale St
MELBOURNE VIC 3000
Ph: 03 8646 3822
Fax: 03 8948 3999

**SUBJECT: ASSET CLASS INDEX RETURNS**

---

Brian,

As per your request, attached please find benchmark returns for major asset class indices.

The table shows the asset class, the index, the data source and the one and three year returns.

Regards

Daniel Craine
Head of Performance, Risk and Options

This information is of a general nature and does not take into account your personal needs or circumstances. Before making a decision about AustralianSuper, consider your financial requirements and refer to the relevant Product Disclosure Statement. AustralianSuper Pty Ltd (Trustee of AustralianSuper) ABN 94 006 457 987 AFSL 233788 RSEL L0000796 RSE R1001693. AustralianSuper was established in July 2006 by the merger of Australian Retirement Fund (ARF) and Superannuation Trust of Australia (STA).

## Attachment 1: Benchmark Returns

Benchmark returns
As at 30/6/2015
Accumulation returns (including dividends)

| Asset Class | Sub Asset Class | Benchmark | Source | 1 year | 3 year (annualised) |
|---|---|---|---|---|---|
| International Equities | Developed | MSCI World ex-Australia Index (in local currency) | Factset | 8.5% | 17.1% |
| | Emerging | MSCI Emerging Markets Index (local currency) | Factset | 6.2% | 8.6% |
| | All | MSCI All Country World ex-Australia (local currency) | Factset | 8.3% | 16.0% |
| Australian Equities | | S&P ASX 200 Accumulation Index | Factset | 5.7% | 15.1% |
| Property | | Mercer/IPD Unlisted Property Index (NAV post fee) | Mercer IPD | 10.0% | 9.0% |
| Infrastructure | | AustralianSuper Internal | AustralianSuper | 6.9% | 10.3% |
| Global Bonds | | Barclays Global Aggregate Index hedged in AUD | Factset | 5.6% | 6.0% |
| Australian Bonds | | Bloomberg AusBond Composite Index | Factset | 5.6% | 4.8% |
| Cash | | Bloomberg AusBond Bank Bill Index | Factset | 2.6% | 2.9% |
| Currency | | AUD vs USD | Factset | -18.6% | -9.2% |

This information is of a general nature and does not take into account your personal needs or circumstances. Before making a decision about AustralianSuper, consider your financial requirements and refer to the relevant Product Disclosure Statement. AustralianSuper Pty Ltd (Trustee of AustralianSuper) ABN 94 006 457 987 AFSL 233788 RSEL L0000796 RSE R1001693. AustralianSuper was established in July 2006 by the merger of Australian Retirement Fund (ARF) and Superannuation Trust of Australia (STA).

## Attachment 3

1. Lost Bases of Retail and Industry Funds (from APRA Quarterly Statistics, June 2015)

| | Retail Funds ($m) | Industry Funds ($m) |
|---|---|---|
| Administration and Operating Expenses | 1,051 | 381 |
| Investment Expenses | 141 | 385 |
| Total Expenses | 1,192 | 766 |

2. Indicative costs of asset classes:

| Bonds and Cash | 20bps |
|---|---|
| Property and Infrastructure | 100bps (plus performance fees) |

3. Total assets under management – Retail Funds as at June 2015 - $536 billion.

4. Indicative Investment of transferring 10% of assets from Bonds/Cash to Property Infrastructure:

| 10% x $536 billion x (100bps – 20bps) | = $429 million |
|---|---|

#4

# Compare the pair

| Average Industry Super Fund | Average Retail Master Trust |
| --- | --- |
| $328,789 | $281,372 |

The comparisons show projected outcomes, applying today's average fees for a sample of Industry Super Funds and a sample of Retail Master Trusts, over 25 years. * Differences in fees may change in the future and this would alter the outcome.

Industry Super Funds currently have lower fees than the average fees charged by the average Retail Master Trust, do not pay sales commissions and are run only to profit members. To find out more call **1300 881 371** or visit **www.industrysuper.com**

*The amounts are not predictions or estimates of actual outcomes. Outcomes will vary between individual funds.

**Above example is a comparison of two employees age 40, each with a starting account balance of $50,000 and initial income of $58,000.** Comparisons modelled by SuperRatings, commissioned by Industry Fund Services P/L ABN 54007016195 AFSL 232514. The modelling is based on various assumptions not all of which are shown here. Please refer to http://www.industrysuper.com/assumptions where these assumptions are shown and explained. The figures shown are current at 30 September 2007 and may be revised if further information becomes available.

Consider your own objectives, financial situation and needs before making a decision about superannuation because they are not taken into account in this information. You should consider the Product Disclosure Statement available from individual funds before making an investment decision.

A lifetime of difference

Your Industry Super Fund for building and construction

# Compare the pair

**Average Industry Super Fund**

**$552,012**

**Average Retail Master Trust**

**$486,461**

**The comparisons show projected outcomes, applying today's average fees for a sample of Industry Super Funds and a sample of Retail Master Trusts, over 20 years. *Differences in fees may change in the future and this would alter the outcome.**

Industry Super Funds currently have lower fees than the average fees charged by the average Retail Master Trust, do not pay sales commissions and are run only to profit members. To find out more call **1300 881 371** or visit **www.industrysuper.com**

*The amounts are not predictions or estimates of actual outcomes. Outcomes will vary between individual funds.

**Above example is a comparison of two employees age 45, each with a starting account balance of $110,000 and initial income of $130,000.** Comparisons modelled by SuperRatings, commissioned by Industry Fund Services P/L ABN 54007016195 AFSL 232514. The modelling is based on various assumptions not all of which are shown here. Please refer to http://www.industrysuper.com/assumptions where these assumptions are shown and explained. The figures shown are current at 30 September 2007 and may be revised if further information becomes available.

Consider your own objectives, financial situation and needs before making a decision about superannuation because they are not taken into account in this information. You should consider the Product Disclosure Statement available from individual funds before making an investment decision.

A lifetime of difference

An Industry Super Fund that anyone can join

# Compare the pair

**Average Industry Super Fund** **$468,195**

**Average Retail Master Trust** **$384,125**

**The comparisons show projected outcomes, applying today's average fees for a sample of Industry Super Funds and a sample of Retail Master Trusts, over 35 years. * Differences in fees may change in the future and this would alter the outcome.**

Industry Super Funds currently have lower fees than the average fees charged by the average Retail Master Trust, do not pay sales commissions and are run only to profit members. To find out more call **1300 881 371** or visit **www.industrysuper.com**

A lifetime of difference

*The amounts are not predictions or estimates of actual outcomes. Outcomes will vary between individual funds.

**Above example is a comparison of two employees age 30, each with a starting account balance of $46,333 and initial income of 47,000.** Comparisons modelled by SuperRatings, commissioned by Industry Fund Services P/L ABN 54007016195 AFSL 232514. The modelling is based on various assumptions not all of which are shown here. Please refer to http://www.industrysuper.com/assumptions where these assumptions are shown and explained. The figures shown are current at 30 September 2007 and may be revised if further information becomes available.

Consider your own objectives, financial situation and needs before making a decision about superannuation because they are not taken into account in this information. You should consider the Product Disclosure Statement available from individual funds before making an investment decision.

Your Industry Super Fund for Motor Trades

# Compare the pair

**Average Industry Super Fund**

**$204,076**

**Average Retail Master Trust**

**$169,033**

**The comparisons show projected outcomes, applying today's average fees for a sample of Industry Super Funds and a sample of Retail Master Trusts, over 40 years. *Differences in fees may change in the future and this would alter the outcome.**

Industry Super Funds currently have lower fees than the average fees charged by the average Retail Master Trust, do not pay sales commissions and are run only to profit members. To find out more call **1300 881 371** or visit **www.industrysuper.com**

*The amounts are not predictions or estimates of actual outcomes. Outcomes will vary between individual funds.

**Above example is a comparison of two employees age 25, each with a starting account balance of $4,400 and initial income of $23,000.** Comparisons modelled by SuperRatings, commissioned by Industry Fund Services P/L ABN 54007016195 AFSL 232514. The modelling is based on various assumptions not all of which are shown here. Please refer to http://www.industrysuper.com/assumptions where these assumptions are shown and explained. The figures shown are current at 30 September 2007 and may be revised if further information becomes available.

Consider your own objectives, financial situation and needs before making a decision about superannuation because they are not taken into account in this information. You should consider the Product Disclosure Statement available from individual funds before making an investment decision.

A lifetime of difference

Your Industry Super Fund for hospitality, tourism and sport

HOSTPLUS
expect more

25 Jul 2015
Weekend Australian, Australia

Author: Alan Kohler • Section: Business News • Article type : News Item
Audience : 227,486 • Page: 25 • Printed Size: 536.00cm² • Market: National
Country: Australia • ASR: AUD 17,504 • Words: 1222 • Item ID: 439830072

#5

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# Planned superannuation changes could leave members worse off

ALAN KOHLER
BUSINESS EDITOR-AT-LARGE

The government's proposed shake-up of the governance of Australia's superannuation seems perfectly uncontroversial: who can complain about requiring a third of the board of trustees of a super fund to be independent?

In fact the draft legislation released last week by the Assistant Treasurer Josh Frydenburg goes much further than that, and many industry funds think it could eliminate the distinction between them and retail funds as well as their superior performance.

The legislation not only requires a third of the directors to be independent from unions and employers, it will also remove the existing requirement for equal representation.

That also seems uncontroversial. If a third of the directors are to be independent, why should there be a statutory requirement that the other two-thirds be equally split between unions and employer groups?

That's certainly the government's view. And, anyway, isn't it a good idea to end the industrial relations club's control over part of the national savings pool and retirement system?

Well, yes, except the members of industry funds have consistently enjoyed more comfortable lifestyles in retirement than the members of commercial retail funds, and that has a lot to do with the way those funds are governed.

That is, they are not run by independent company directors who have a statutory responsibility to members and are concerned mainly with compliance, but by people who are actually employed as representatives of members and their employers.

In other words, their lives are engaged in representation; it's not a theoretical concept but an everyday fact.

And there's nothing theoretical about the better performance of industry funds.

According to research house ChantWest, eight of the top 10 performing super funds in the 2014-15 financial year were industry funds.

The average performance of

Continued on Page 35

25 Jul 2015
Weekend Australian, Australia

Author: Alan Kohler • Section: Business News • Article type : News Item
Audience : 227,486 • Page: 25 • Printed Size: 536.00cm² • Market: National
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# Government's planned superannuation changes could leave members worse off

*Continued from Page 25*

industry funds for the year was 10.2 per cent versus 9.6 per cent for retail funds; over 15 years the returns have been 6.9 and 5.8 per cent respectively. Over a 35-working life for someone on a salary of $70,000, that difference turns into $200,000 at retirement — $880,000 versus $680,000.

Of the top 50 performing super funds over 10 years, 19 are industry funds and two are retail funds. Of the bottom 50, seven are industry funds and 40 are retail funds. None of the top 10 funds over 10 years is a retail fund.

So arguably the government should be legislating to require retail funds to be governed in the same way as industry funds, with equal representation, not the other way around.

None of the studies into superannuation, and certainly none of the announcements from the government on governance, has successfully answered the question of why industry funds almost always perform better than retail funds. Obviously part of the reason is that they are not-for-profit, which means a profit margin does not have to be subtracted from the returns to service the equity capital provided by shareholders.

But that's not the whole answer. Retail funds are actually cheaper to run, not more expensive. According to APRA statistics, the average operating expenses of industry funds in the year ended March 2015 was $32 million, whereas for retail funds it was $26.5m.

In fact the main reason industry funds perform better than retail funds is that they change asset allocations more often and they put more money into unlisted investments, mainly infrastructure.

Retail funds tend to have "set and forget" percentages applied to each asset class because independent directors are less inclined to take what they regard as bets.

That conservatism also leads them to invest more in liquid investments, mainly listed equities.

According to APRA statistics, at March this year industry funds, in aggregate, had 6 per cent of their funds in unlisted equities, 7 per cent in infrastructure and 7 per cent in unlisted property for a total of 20 per cent in unlisted assets.

Retail funds had 3 per cent in unlisted equities, 1 per cent in infrastructure and 2 per cent in unlisted property — a total of 6 per cent.

That is the key difference in the performance, along with the fact that the trustee boards of industry funds are prepared to make bigger changes to overall asset allocations in response to market conditions.

It's impossible to prove, but in my view this is primarily due to the fact that the trustees are direct representatives of employees and employers.

But whatever the reason, the fact is that the representative trustee boards have performed better than the others.

Now the legislative requirement for equal representation — any representation — is to be removed.

The people most pleased with this, apart from Coalition politicians keen to remove the influence of unions from superannuation, will be the bankers who run the retail super funds and who have been shown up by the industry funds for 20 years.

They have been lobbying hard to level the playing field, and have now finally succeeded.

The government's response to questions about why equal representation is being removed from the law is: they can still appoint employer and union representatives, and they can make them equal if they want — why does that need to be mandated?

Because the make-up of industry fund trustee boards will gradually drift. Unions or employer bodies will sometimes lose interest and more independents will be appointed; over time, independent directors will probably dominate the boards. (David Murray's Financial System Inquiry recommended more than half should be independent, but then he's a banker.)

There's no requirement for these funds to be not-for-profit, so it's even possible that once professional company directors control them some might decide to demutualise and become commercial funds.

Equal representation is one of the fundamental attributes of industry funds; changing it is likely to have unintended consequences — or rather intended by competitors and political enemies, but unintended by members.

There is another new provision in the draft legislation that is, in some ways, even more extraordinary.

The new law, if passed, would require any new super fund director to be approved by APRA before they are appointed.

What's more, if APRA doesn't respond to the request for approval, that is to be taken as a refusal. The draft contains this remarkable paragraph: "If APRA has not decided the application by the end of the period by which APRA is required to decide it, APRA is taken to have decided, at the end of the last day of that period, to refuse the application."

And while the draft sets out the required attributes of an independent director of a super fund, the legislation specifically states that APRA can ignore that list and make its own judgment about whether someone is independent, and refuse the application even if

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the person complies with all the requirements.

So not only can APRA block the appointment of a director even if the person fits the requirements for independence, and not give any reasons for the refusal, it doesn't have to say anything at all — just ignore the application.

Did APRA ask for this power? Or has it been thrust upon it? No one knows, or will comment.

One thing is for sure: the changes to the governance of super funds are neither small nor uncontroversial.

SIMONE SMITH

**Bankers' buddy: Assistant Treasurer Josh Frydenburg**

## Attachment 2

## Board Governance of NFP

# Board Governance of Not for Profit Superannuation Funds

Bernie Fraser

16 February 2017

David Whiteley
Chief Executive
Industry Super Australia
2 Lonsdale St
Melbourne VIC 3000

Tom Garcia
Chief Executive Officer
Australian Institute of Superannuation Trustees
Ground Floor, 215 Spring Street
Melbourne VIC 3000

Dear David

Dear Tom

**BOARD GOVERNANCE OF NOT FOR PROFIT SUPERANNUATION FUNDS**

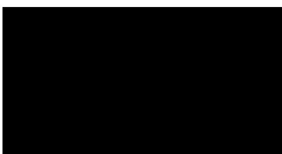
My report on this subject is attached.

For such a brief document it has been sometime in the making; as you know, this happenstance has a good deal to do with uncertainties flowing from the mid-2016 Federal election.

Should you wish it, I would be happy to participate in any discussions on the report with relevant stakeholders, including cross-bench senators.

I have appreciated the assistance provided by officers of Industry Super Australia in the preparation of this report.

Yours sincerely



Bernie Fraser

16 February 2017

**GLOSSARY**

| | |
|---|---|
| ACTU | Australian Council of Trade Unions |
| AICD | Australian Institute of Company Directors |
| AiG | Australian Industry Group |
| AIST | Australian Institute of Superannuation Trustees |
| ATO | Australian Taxation Office |
| APRA | Australian Prudential Regulation Authority |
| ASIC | Australian Securities & Investments Commission |
| ASX | Australian Securities Exchange |
| EM | Explanatory Memorandum |
| Fintech | Financial Technology |
| FSC | Financial Services Council |
| FSI | Financial System Inquiry |
| GFC | Global Financial Crisis |
| IFF | Industry Funds Forum |
| ISA | Industry Super Australia |
| NFP | Not For Profit |
| PPG | Prudential Practice Guide |
| RSE | Registrable Superannuation Entity |
| SIS | Superannuation Industry (Supervision) Act |
| SMSF | Self-Managed Superannuation Fund |
| SPS | Superannuation Prudential Standards |
| The Bill | The Superannuation Legislation Amendment (Governance) Bill 2015 |

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## BACKGROUND

The Superannuation Legislation Amendment (Governance) Bill 2015 (the Bill) was introduced in the House on 16 September and passed in that chamber on 20 October 2015. The Bill was introduced in the Senate on 9 November 2015. The stated purpose of the Bill was to raise the governance standards of all superannuation funds (including industry and other "not for profit" funds), primarily by mandating that their Boards of Directors comprise a minimum of one-third "independent" directors, including an “independent” Chair.

The appropriateness and motivation of these proposals were questioned by representatives of the not for profit (NFP) funds. Several of the then cross-bench Senators were unwilling to support the Bill and it was suggested that the interests of members of NFP funds might be better served by an appropriate code of Board governance, rather than the proposed mandatory requirements in respect of “independents”. This led to the deferment of further consideration of the Bill pending a report on a possible voluntary code. The Bill lapsed when Parliament was prorogued on 17 April 2016.

In early December 2015, I agreed to a request from Industry Super Australia (ISA) and the Australian Institute of Superannuation Trustees (AIST) to review the Government’s proposed changes as they related to NFP funds, and to suggest alternative arrangements for those funds.[1] In response to a request for public submissions some 22 submissions were received, almost all of which were released on ISA’s website.[2] Letters were sent to the major stakeholders [3] (and to the relevant Minister)[4] outlining the proposed approach of the review and requesting their cooperation.

Extensive discussions were held in the early months of 2016. These included meetings with several cross-bench senators, Australian Industry Group (AiG), Australian Council of Trade Unions (ACTU), Australian Institute of Company Directors (AICD), Australian Securities & Investments Commission (ASIC), Australian Prudential Regulation Authority (APRA), and the Boards of the two sponsoring organisations (ISA and AIST). A Review Team also met with several academics familiar with governance arrangements pertaining to local and overseas superannuation funds.[5]

The consultative processes and the finalisation of the report were interrupted by last year's federal election, which was announced on 8 May and held on 2 July. Given the uncertainties surrounding the election outcome, including the likely make-up of the new Senate and the priority the in-coming Government might attach to the earlier Bill, it made sense to hold over completion of the review until there was greater clarity on these issues; this decision was conveyed to major stakeholders on 3 May 2016.[6]

With the passage of time these uncertainties have been largely resolved. Most recently, in the course of an address at an ISA conference on 22 November, the Minister for Revenue and Financial Services announced the Government's intention to re-introduce its earlier Bill relating to governance arrangements, but did not indicate when this might occur. With this confirmation that the Bill remains “live” and would be reintroduced, the report has been completed and made available to interested parties.

## OVERVIEW

It was generally understood that the central focus of the report would be to review the Bill's mandatory requirements for independent directors (and chairs), particularly as they might impact on members of NFP funds. The alternative arrangements covering independence issues for these funds was to be an integral part of the review.

Any review of this kind must start with some clarity about the benchmarks against which different proposals can be judged and assessed. In the view of the Government (and others) the proposals in the Bill represent “best practice”, based on experiences both of other financial institutions in Australia, and of comparable superannuation funds internationally. But are those the most appropriate benchmarks, particularly if there were significant differences between the funds targeted by the Bill and institutions in the benchmarks? Or, as some seem to think, is any benchmark really a secondary consideration alongside an unshakeable belief that “representative” directors of employers and members couldn’t possibly be as good as “independent” directors?

The start and finish point of this review is that what matters most in assessing the proposals in the Bill – and possible options – should be their likely consequences for the members of the funds directly in the firing line.

From that perspective, considerations other than how many of the directors sitting around the Board tables of NFP funds happen to be "independents" might be expected to be much weightier; the values and skills of those directors in particular. Fleshing out the case for concentrating on these really critical considerations is a major part of this report; in the process, its focus shifts from the "independence" thrust of the Bill to the values and skills of real Boards of Directors. This is not to imply that "independence" as such is unimportant – or that independent directors and Chairs cannot bring critical values and skills (they can and do in many cases) – but to argue that the priority from the perspective of members of NFP funds should be squarely on the latter. The limited recommendations in this report seek to promote members' interests by elevating the sources of potentially greatest benefit to them – the values, skills and experience of their Boards – to top billing, ahead of independence as such.

## WHY MANDATE MINIMUM INDEPENDENTS?

In the absence of any indications to the contrary, it has been assumed in preparing this report that the re-introduced Bill will mirror the original. As mentioned earlier, the major changes proposed in the Bill would require a minimum of one-third of Board Directors (including the Chair) of all superannuation funds to be "independent". It would also repeal the current legislative provisions underpinning of the equal representation model of NFP funds (that is, equal member and employer representation on Boards).

In addition, the Bill proposes that APRA be given an over-riding power in determining whether a person viewed as a prospective director of a superannuation fund actually qualifies as "independent".

Boards of Directors are ultimately responsible for the performance and behaviour of the funds which make up this country's substantial superannuation industry. Collectively, these funds manage more than $2 trillion of the retirement savings of nearly 12 million

Australians, of which roughly one third supports company investments, and infrastructure and property developments, in Australia. They are also tax-privileged institutions, with the value of revenue foregone through taxation concessions (or "tax expenditures") estimated to be in the order of $30 billion annually. For all those reasons – of which the protection of members' compulsory retirement savings rates most highly – quality Board governance of all superannuation funds – including NFP funds – is rightly an important policy goal of governments.

It is far from self-evident, however, that simply mandating minimum numbers of "independent" directors will deliver quality or "best practice" Board governance for all super funds: that case has to be made, not inferred or asserted.

The Government's main arguments in support of mandated requirements – as distilled mainly from the Explanatory Memorandum (EM) accompanying the Bill and from related Ministerial statements – are canvassed briefly below:

(i) Independents bring "...an independent kind of thinking to boards ..." and provide "...an external dispassionate perspective enabling boards to benefit from a diversity of views..." They also "... ask the right questions ..." These and similar comments/quotations appear throughout the EM, which attaches considerable weight to "independence of mind" and its inferred attributes.

These characteristics no doubt contribute to the proper functioning of Boards, but they are hardly intrinsic to directors who count as "independent", and absent in other directors. In terms of their ultimate value to fund members, the retail ("for-profit") funds – which have majorities of independents on their Boards – consistently underperform NFP Funds.

(ii) Independent directors hold other directors and fund managements "more accountable" – to a greater degree, presumably, than non-independent directors.

Again it is far from clear why this should be so; it is not demonstrated in the relative returns to members of retail and NFP funds, or in their respective behaviour report cards.

(iii) Independent directors avoid conflicts of interest that can cause non-independent directors to act – "either intentionally or unintentionally" – contrary to the best interests of members.

Conflicts can arise for various reasons in any fund, irrespective of the mix of independent and other directors, and all Boards are required by APRA to have procedures for handling them (including, for example, on disclosures, and on the non-participation of directors in decision-making on certain issues).

To the extent that potential conflicts of interest (and duty) are a function of the number of different "interests" in play around Board tables, it is reasonable to expect that the incidence of actual conflicts would be somewhat greater in the case of retail ("for profit") funds, which face the task of reconciling the interests of two powerful and somewhat aligned groups (shareholders and senior executives[7]), and of a third and generally less powerful group (customers/clients): compared with NFP funds which focus on their members alone. This point, which goes to the heart of the question of "independence", is elaborated below.

(iv) A variant of the previous point is the argument that as the membership of some funds expands and becomes more diversified – through, for example, amalgamations and "public offers" – this diversified membership is entitled to see more "independent" directors in these funds, and fewer appointees from particular union and employer groups which may have become less "representative" of today's membership than they were in the earlier times.

This argument supports the suspicion that industry super funds are a particular target of the proposed changes: their funds under management have grown rather faster over the past decade than those of retail funds (see Table 2).

The more substantive response is to repeat the comment on point (iii), namely, that the Boards of NFP funds are focussed inherently on advancing the interests of all their members, irrespective of any particular industry or other affiliations individual "representative" directors might have. The sustained growth of these funds is reflective

of their good on-going performances: it hardly suggests a failed business model that is disadvantaging any of its members.

(v) More independents on the Boards of super funds would bring Australia into line with "international best practice". The EM quotes from the Financial Services Inquiry (FSI) report which noted:

> "…. including independent directors on boards is consistent with international best practice …."

Governance practices in other countries can be of interest and, at times, provide insights that help to improve practices in Australia - but they rarely come in ready-made and readily transferable packages. What turned out to be exceptionally bad behaviour and sloppy risk management practices on the part of many American and European banks and other financial institutions – of which the GFC is their continuing legacy – were widely regarded as "best practices": fortunately, they were not practices which Australian institutions were pressed to import.

Governance structures of superannuation funds around the world exhibit considerable diversity, reflecting their different histories and cultures. The make-up of Australia's superannuation funds, including their structures, goals and governance, similarly reflect their peculiarly Australian histories and cultures: this should be remembered when assessing both the proposals in the Bill and possible alternative approaches. In other words, the search for improvements in current Australian practices is likely to prove most fruitful when it is based on an in-depth understanding of the domestic landscape, (including, for example, the different priorities of retail and NFP funds), rather than looking to lift particular models from overseas. That said, the proposal in the Bill to attack the equal representation model of NFP funds is contrary to the support shown worldwide for this model, including in a majority of OECD countries.

(vi) Independent directors can bring different skills and experiences, and expand the pool of talent available to the boards of all funds.

> There is no question that the mix and quality of the skills and experiences represented around the Board tables are major drivers of performance for all funds. The importance of skills and experience is elaborated later in the report, where it is argued that these attributes in Board members – particularly of NFP funds – far outweigh any appeal of their “independence” as such.

Many of these arguments for mandated minimum numbers of independents rely heavily upon assertion, rather than reason and evidence. Sadly, this has come to characterise so much public policy “debate” in this Age of Assertion. Whether driven by ideology, pressures from lobbyists, or something else, the assertion card is increasingly and shamelessly played to trump sound reasoning and solid evidence – even on a matter as far under the radar as Board governance of superannuation funds. Very much in this vein is the Minister’s recent claim that "...governance standards for superannuation funds under the law are lower than for banks and life insurance companies ..."[8]

Some aspects of points (i) to (vi) are re-visited below. For the most part, however, the case for the main proposals in the Bill rely more on assertions than on hard evidence of either on-going problems in the governance of NFP funds, or of the necessity for mandated minimum independent requirements to be imposed on those funds. The thinking underlying the Bill ignores the diversity – between retail and NFP funds, and in the size, cultures and performance – within the industry. It also suggests that, to the extent the Bill really seeks to enhance members’ interests through increased “independence” it is, by taking aim at NFP funds, attacking the wrong target.

## SNAP-SHOT OF THE AUSTRALIAN SUPERANNUATION INDUSTRY

The following tables provide a quick snap-shot of the Australian superannuation industry, primarily to highlight its considerable diversity.

**Table 1: Number of Superannuation Funds, by Sector**

| | June 2006 | June 2016 | Change (%) |
|---|---|---|---|
| **Retail** | 251 | 135 | -46 |
| | | | |
| **Not-for-Profit:** | 407 | 109 | -73 |
| **- Corporate** | 295 | 30 | -90 |
| **- Industry** | 68 | 41 | -40 |
| **- Public sector** | 44 | 38 | -14 |
| | | | |
| **SMSF** | 309,088 | 577,236 | 87 |

*Source: APRA Annual Superannuation Bulletin, June 2016*

Significant reductions occurred in the numbers of most funds over the past decade, and especially so for corporate not for profit funds (as employers have outsourced this "non-core" function) and in industry funds (driven largely by mergers). SMSFs have grown solidly over the period; nearly three quarters of these funds have two members and most of the remainder have only one member. These funds are administered by the ATO (rather than APRA) and are not affected by the Bill; they are included in the tables to highlight the rapid growth of the sector, to the point where it now represents close to one-third of the whole industry in terms of assets.

**Table 2: Growth in Member Accounts and Net Assets, by Sector**

| | June 2006 | June 2016 | Change (%) | June 2006 | June 2016 | Change | Share assets (%) |
|---|---|---|---|---|---|---|---|
| **Retail** | 14,991 | 12,978 | -13 | 302 | 543 | 80 | 27 |
| **Not-for-Profit** | 13,424 | 14,992 | 12 | 340 | 835 | 146 | 42 |
| **- Corporate** | 469 | 341 | -27 | 42 | 53 | 26 | 3 |
| **- Industry** | 9,836 | 11,118 | 13 | 144 | 445 | 209 | 22 |
| **- Public sector** | 3,119 | 3,533 | 13 | 154 | 337 | 119 | 17 |
| | | | | | | | |
| **SMSF** | 594 | 1,088 | 83 | 203 | 622 | 206 | 31 |

*Source: APRA Annual Superannuation Bulletin, June 2016*
*Note: SMSFs assets refer to total assets *Data are not available on the number of superannuation fund members; changes in the number of member accounts is a very rough proxy, given the incidence of multiple accounts.*

Funds under management of retail ("for profit") funds increased by 80 per cent over the past decade, and represented approximately 27 per cent of the industry total at 30 June 2016. Retail funds are owned mostly by the major banks and life offices. Their trustee Boards were traditionally dominated by executive directors but from 2014 the Financial Services Council (FSC) has required the trustee Boards of their members to have a majority of independent directors and an independent Chair. Most retail funds are members of the FSC and comply with this requirement.  Many of the appointed "independent" directors have had careers as finance executives. In addition, trustee boards for the major banks typically govern a number of separate super funds on behalf of the banks and their independent directors sit as "independents" on these multiple Boards. Perhaps a little ironically, compared with the current FSC requirement for a majority of independent directors, the Bill would reduce the minimum requirement for retail funds to one third.

The NFP funds (more accurately described as "all profits to members" or just "profit to member funds") collectively grew by 146 per cent over the past decade (rather faster than retail funds) and currently make up about 42 per cent of the total industry. Within this sector, industry funds recorded the fastest growth over the past decade (more than 200 per cent), making up 22 per cent of the whole industry, followed by public sector funds (17 percent) and corporate funds (3 per cent). More than half of industry funds follow the "typical" equal representative trustee model, with an equal number of employer and employee directors nominated by employer associations and unions. A small number follow a similar structure, but their member representatives are directly elected. Others have a

variety of arrangements, which include holding member elections for all directors, and Board/Committee involvement in nominating either member or employer directors (or all directors). Industry funds range in asset size from around $650 million in funds under management (with about 9000 members) to over $100 billion (and more than 2 million members).

Both public sector and corporate funds also broadly follow the equal representation trustee model. The predominant approach in respect of the former is for member directors to be nominated by relevant unions and employer directors by employer(s). Other approaches include Board nominations, member elections or direct appointments by Ministers. Some of the public sector funds are subject to federal or state laws, with their own legislative requirements. Several public sector funds have appointed independent directors. The employer directors on corporate funds are generally nominated by the employer, while member directors are elected by members from among the employees of the company, or nominated by the union covering those employees.

The best evidence that the NFP model is not broken is embodied in Table 3. This shows that the net returns to members of NFP funds – collectively and separately – have consistently and significantly exceeded returns to members of retail funds.

**Table 3: Net returns to members, by Sector, to June 2016**

| | 1 year | 5 years | 10 years | 20 years |
|---|---|---|---|---|
| **Not-for-profit** | 3.8 | 8.2 | 5.4 | 6.6 |
| **- Corporate funds** | 2.5 | 7.4 | 5.1 | 6.5 |
| **- Industry funds*** | 4.1 | 8.3 | 5.4 | 6.3 |
| **- Public Sector** | 3.6 | 8.2 | 5.3 | 6.8 |
| | | | | |
| **Retail funds** | 1.6 | 6.4 | 3.6 | 4.5 |
| **Outperformance of NFP over Retail** | 2.2 | 1.8 | 1.7 | 2.2 |

*Source: ISA analysis of APRA Annual Superannuation Bulletin, June 2016 and APRA 2007-Insight-issue-2 celebrating 10yrs of Superannuation Data Collection 1996-2006. Note: Not-For-Profit net returns are assets weighted averages. *Note SuperRatings estimate that industry funds outperformed bank owned funds by 2.7 per cent on average in 2016; by 2.1 per cent over three years; 2.2 per cent over five years and by this same margin (2.2 per cent) over ten years.*[9]

Several factors contribute to the sustained outperformance of NFP funds. For a start, they are all structured to focus on their members' interests above all others: they are effectively "mutuals", where fund members are also the shareholders. The equal representation model also has meant that directors traditionally have had close ties with the industries their fund members worked in. The alignment of interests and loyalties arising from these ties have bolstered the "members first" focus of NFP funds, both to make good investments for members and to restrain cost increases (through, for example, a hard-nosed approach to the fees paid to managers and other service providers, and to staff remuneration relative to retail funds).

Other factors also contributed. From their early days industry funds, for example, benefited from a core of directors who were mindful of risks, but also prepared to be innovative, venturing into infrastructure and direct property investments well before these asset classes became fashionable, and "collective vehicles" were established to assist small and fledging funds to gain exposures to those longer-term assets. Over time the skill levels of NFP funds generally have risen in step with their investments, to the point where – as Table 3 suggests – their strategies, asset allocations and risk management processes are more than competitive. At the same time, the culture and values which reflect where they came from continue to define what they stand for today.

Clearly, the NFP model is not broken. It is, however, facing some challenges. As already mentioned, the Government's Bill would undermine the equal representation governance model which has contributed to outperformance. And, despite its less than stellar success in fairly reconciling the often conflicting interests of shareholders, management and customers, "corporatisation" has largely driven out the "mutualisation" – although not (yet) in the superannuation industry. Another challenge is the likely competition for people with special skills and experiences in the years ahead. With the globalisation of flows of not only goods and services and capital but also of people, technologies and ideas – with all their attendant geopolitical ramifications – investment and other risks are on the rise[10]. Good governance is largely about effective management of these risks, and all superannuation funds will require directors with the requisite skills – a wide diversity of skills, in fact, extending far beyond those that have to do with financial markets.

This snapshot highlights the diversity within the superannuation industry, and particularly the differences between the retail and the NFP sectors. It shows that the NFP sector – with the least number of independent directors (and Chairs) – consistently delivers better returns to members than the retail sector, which casts some doubts on the assumed "silver bullet" qualities of "independence". It also draws attention to what is at the heart of this whole debate: namely, the fundamentally different priorities of retail funds and NFP funds. To repeat this point: Boards of the former, owned by the banks and life offices, have three sets of interests to reconcile - those of shareholders, senior executives and fund members. By contrast, NFP funds have the clear focus of their members - they have no beneficial "shareholders" and their management teams are rather less powerful and less lavishly rewarded than their retail fund counterparts.

This difference in focus is reflected in current governance policies. The Superannuation Governance Policy of the FSC of March 2013 requires that its member retail funds "must" have a majority of "independent directors" on their Boards, and an independent Chair. The ASX Corporate Governance Principles and Recommendations (Third Edition) 2014 – which is applicable to all entities listed on the ASX but is not binding – recommends that these entities "should" have a majority of independent directors and an independent Chair.

The focus on "independence" is perfectly reasonable in respect of retail funds (and listed entities generally); the absence of such requirements for independents would likely see a continuation of the earlier prominence of executive directors on these Boards, with the risk that the distribution of benefits could be skewed against the interests of their members and customers. Or, in the words of the "Commentary" in the ASX Code, bias decisions of the Board "….towards the interests of management or any other person or group with whom a non-independent director might be associated". Notwithstanding the moves towards greater independence of their Boards over recent years, the close alignment of interests of shareholders and senior executives has meant that many members of retail funds (like many customers of their parent banks and life offices) continue to be stuck at the back of the queue.

APRA's recent Prudential Standard on Governance (issued 31 October 2016 and effective 1 July 2017) does not set any minimum requirements for the independence of directors or Chairs of NFP funds. In the non-binding "Guidance" which accompanied the Prudential Standard, APRA expressed its "views" that:

> "….a prudent equal representation Board would consider the appointment of at least one independent director."; and

> "…. a prudent RSE license would consider whether the appointment of an independent as chairperson of the Board would benefit the Board's fulfilment of its duties.".

The Government's proposals in its earlier Bill would, of course, go much further, mandating that all funds, including NFP funds, move to a minimum of one-third independent directors (including an independent Chair) within three years.

The Bill also proposed significant changes in respect of the definition of "independent director". The definition in the SIS Act 1993 which currently applies to "equal representation" industry and other NFP funds is relatively straight-forward. It defines as independent:

> "… a trustee of the fund who:

a) is not a member of the fund; and
b) is neither an employer-sponsor of the fund nor an associate of such an employer-sponsor; and
c) is neither an employee of an employer-sponsor of the fund nor an employee of an associate of such an employer-sponsor; and
d) is not, in any capacity, a representative of a trade union, or other organisation, representing the interests of one or more members of the fund; and
e) is not, in any capacity, a representative of an organisation representing the interests of one or more employer-sponsors of the fund."

The Bill also takes a prescriptive, rather than principles-based, approach to the definition of "independent": it prescribes a number of ownership and other relationships between the director and the fund which, if they existed, would preclude the director being labelled "independent". The EM has three pages of illustrations of the kinds of arrangements that would "prevent independence". The Bill would also extend APRA's powers to potentially allow it to overturn a judgment of "independent" consistent with the terms of the proposed legislative tests if APRA was not convinced the person in question had "the ability to exercise independent judgement in performing the role of a director". These powers would go beyond what APRA currently possesses in respect of banks and life offices. This paraphernalia of definitions, rules and illustrations of the kinds of situations which might and might not satisfy tests of "independence" is a veritable playground for many lawyers but a challenging maze for many funds.

The debate about independence really comes down to the question: "independence from what?". To the extent that the answer is independence from executive management, this is hardly an issue for the governance of NFP funds, which effectively ban executive directors from their Boards. A broader – and arguably better answer – to the question is to view independence as a defence from all the dangers and obstacles that can get in the way of pursuing a clear and committed objective. Such independence is never absolute but it is inherently more substantial for member focussed NFP funds than it is for retail funds.

## TWO OPTIONS

My remit was to review the Government's proposals to mandate minimum numbers of “independent” directors (including the Chair) on the Boards of all super funds, and to consider whether some alternative approach was potentially more beneficial from the perspective of NFP funds and their members.

Two options suggest themselves. One course would be for NFP funds to go along with the Government's proposals, perhaps after some wrangling to extend the three year transition period. Some might see this as a relatively easy option, particularly given that NFP funds themselves have been appointing more “independents” to their Boards over recent years.

Relatively easy it might be, but is it the best option for members of NFP funds? A little reflection suggests it is not. To mandate the same Board governance requirements for all super funds, as if they were homogeneous entities pressed from the same mould, would be to ignore the stark differences which exist within the industry (are canvassed in the report). That diversity is a source of competition and strength for the industry, and not something to be whittled away as the proposals in the Bill seek to do. More fundamentally, the Government’s proposals should be judged ultimately on whether they would deliver the best possible outcomes for fund members: even with some amendment the risks in the Bill for member benefits are all on the downside compared with a course of positive actions to enhance members’ returns.

The debate around the appointment of more independent directors is largely peripheral to the betterment of the benefits that flow to members of NFP funds: that has much more to do with sharpening and strengthening the values and skills on the Boards of these funds. To reiterate some of the points made previously:

(i) their “mutual” structure and the associated creed of all profits to members make NFP funds a notably distinct sector of the superannuation industry;
(ii) combined with their solid performance record they have become a trusted and respected brand, not only in superannuation but also across the whole financial industry – a real rarity these days;

(iii) the basic cultural and business model that has created this brand is not broken, but it is facing some challenges, not least in attracting sufficient directors with the values and skills critical to sustaining trust in the NFP brand;

(iv) the pronounced member focus of NFP funds reduces the potential for conflicts of interest compared with retail funds with multiple stakeholders, where conflicts for directors too often become conflicts over fairness and justice for their members; and

(v) over time more directors of industry funds in particular are likely to be appointed from outside the major sponsoring organisations, many of whom might be expected to satisfy reasonable tests of "independence" and to be counted as "independents" by those who like these labels – any such increments in "independents" would be positive for the funds concerned but it would delivered as the outcome of appointment and other processes weighted heavily towards values and skills, rather than the pursuit of "independence" as such.

While the number of independent directors on the Boards of NFP funds does not loom large as a pressing national policy issue, the members of these funds are likely to feel that the maintenance of governance arrangements akin to those which have proved notably beneficial in the past are worth fighting for, in preference to the Government's proposals. As a member of a well-performing NFP fund, would you prefer that your Board strive harder to strengthen the underlying drivers of that good performance – largely values and skills – or risk getting hung up on how many independents should sit around the Board table? The old notion of "mutuality" in financial and other activities is now less common but NFP funds continue to demonstrate that model is alive and prospering in the superannuation industry. They operate successfully in some of the most competitive markets in the world but their focus on and loyalty to their members remains undiminished.

The Government's message that its proposals to raise the proportions of independents on the Boards of NFP funds to levels comparable with those of banks and life offices will deliver benefits to fund members is not persuasive. Many members and customers of financial institutions with majorities of independents on their Boards have felt let down in their dealings with those institutions over recent years, and left out of their profits.

Neither the NFP nor the for-profit superannuation sectors have escaped scot-free from the appalling governance practices which have dogged the banking sector over the past decade. In the NFP sector, relatively isolated and short-lived incidents (Cbus and MTAA Super come to mind) have attracted a certain possible notoriety which seems to be out of all proportion to the actual harm inflicted on members. In the retail sector the mention of just two words – "financial planners" – is sufficient to evoke visions of scales of harm and injustice that have heavily weighed down for-profit funds.

## IMPROVING BOARD GOVERNANCE OF NFP FUNDS

Despite these regrettable lapses, in parts of both the for-profit and NFP sectors – and the damage to the members and brands of the funds concerned – the Australian superannuation industry overall has maintained relatively high governance standards. The industry has grown rapidly in a short period but has avoided the worst of the financial difficulties, bad behaviour and customer backlashes which have dogged many other financial institutions and sullied their brands.

Much of the credit for this outcome should go to APRA for its deft regulation of the superannuation industry to this time. In the governance area, APRA has issued numerous Superannuation Prudential Standards (SPSs), which funds must comply with; it has also issued Prudential Practice Guides (PPGs) outlining its views ("guidance") on what it sees as sound practice in respect of matters covered in its Prudential Standards, although these PPGs do not themselves create enforceable requirements for funds. For the most part, APRA's requirements in respect of Board governance specify broad principles and practices, with some flexibility to accommodate differences among the funds.

The governance arrangements and reviews for the Boards of superannuation funds are, in short, subject to considerable on-going regulation by APRA, ASIC and the provisions of the SIS Act. These processes result in mostly incremental changes – and improvements – in governance. The main changes envisaged in the Bill would not, however, be viewed as "incremental" (or as "improvements") in many eyes. A point not to be forgotten here is that a sound governance framework for superannuation funds is in place – and will remain in place in the event the proposals in the earlier Bill are not adopted.

Of relevance to this review is that the existing framework includes two important Prudential Standards issued by APRA which remain central to the consideration of the qualities of people to be appointed directors of superannuation funds, and how they might behave at Board meetings. One details APRA's requirements relating to the fitness and propriety of "responsible" people (SPS 520), and the second specifies requirements relating to the management of conflicts of interest (SPS 521). Both Standards remain important foundations for building better Boards; properly adhered to they would diminish some of the perceived problems with non-independent directors.

The update of APRA's SPS 510 which is operative from July 2017, provides some additional blocks which NFP funds could build upon to emphasise their special attachment to values and skills in the appointment of directors. The particular requirements are that:

> "the Board must have a governance framework which includes, as a minimum, the Board's charter (or equivalent document) and policies and processes that achieve appropriate skills, structure and composition of the Board;" and
>
> "the Board must have a written policy which sets out requirements relating to the nomination, appointment and removal of directors that support appropriate Board composition and renewal on an ongoing basis"

These requirements – for a formal charter, and policies covering director nominations, appointments and removals – were elaborated in APRA's related PPG. Appropriately, neither the Prudential Standard nor the Guide makes any reference to the implications for these (or other) prudential requirements pending the passage or otherwise of the proposals in the earlier Bill. Overall, the requirements outlined in SPS 510, seem sound and conducive to achieving further incremental improvements in Board governance of superannuation funds. As is usually the case, the requirements are expressed in terms of principles and processes, leaving the way open for individual funds to add flesh to those bones to better describe their particular shape and any unique features. Some actions which NFP funds could take to highlight the importance of values and skills in their make-up are canvassed in the next section.

## ENHANCING VALUES AND SKILLS

1. Boards and Directors

The behaviour and performance of all funds depends on more than their Boards of Directors. The calibre of senior management and staff generally are obviously important also, as are the relationships between the Board and management, and in the case of NFP funds, between the Board and the sponsoring organisations. These matters should be covered in some detail in the governance policies of individual funds, and in any "codes" applicable to sectors of the superannuation industry. In this respect the focus is Board governance, as it was in the Bill, albeit from a different angle.

Boards play vital roles: they set the strategic plans for their funds and monitor performance (including their own) against those plans. They are ultimately responsible – and accountable – for both good and bad outcomes. It is their role to steer their funds through sometimes tough environments and to effectively manage the investment, reputational and other attendant risks along the way. Good values, skill mixes and processes all assist Boards to safely navigate these risks. The suggestions on Board governance which follow would, if they were to be picked up by the funds, be reflected in the relevant comprehensive fund policy or industry code (see below).

*Values*

Issues relating to the values and cultures of different funds do not figure prominently in APRA's Prudential Standards relating to Board governance, or in the Government's Bill. But they do matter. As noted earlier, NFP funds have prospered in part because of the values encapsulated in their "mutuals" model and its creed of "all profits to members" and "members-first" – values generally absent in the corporate model. This has helped to make NFP funds a respected and trusted brand – a rarity in the financial sector these days.

Some measures which would help to enhance these values – and to sharpen their association with NFP funds – are canvassed below:

(i) Fund Charters. As noted earlier, APRA will require all funds to have formal "charters" of the roles, responsibilities and objectives of their Boards from 1 July 2017. These charters will provide an opportunity for NFP funds to declare that the maintenance of their traditional values would remain a clear Board objective in driving future growth. The potential for such a formal "charter" commitment – endorsed by all directors – in helping to keep Boards focused on these special values should not be under-estimated.

(ii) Nominations Committee. Part of the brief from Boards to the Nomination Committees charged with interviewing candidates for directorships should include a requirement for the Committees to undertake a comprehensive assessment of candidates' compatibility with the fund's values when weighing up their suitability as prospective directors.

(iii) Director Declarations. To formally re-enforce their commitment, newly appointed (and reappointed) directors should be required to confirm in writing at the time of their appointments that they understood the particular fund's values, were comfortable with them, and saw no conflicts with them.

Although modest, a package of such measures would help to highlight the member focus of NFP funds, and to strengthen public trust in the brand.

*Skills*

Strong brands also thrive on sustained strong performance, which requires appropriate mixes of skills and experiences, from the Board down. Reference was made earlier to the challenges which economic globalisation, political populism, and the outpouring of new technologies pose for the Boards of all super funds. The consequences of these developments are usually perceived as adding to risks and uncertainty in investment markets, which they do. But they might also open up some opportunities (in "fintech" for example) which could help to improve the ways members and their funds communicate and transact business. Perhaps the single most important determinant of the future performance of all funds (and their members' future benefits) is how well their Boards collectively understand and handle these diverse challenges.

APRA's Prudential Standard SPS 510 includes the following paragraph which is relevant to those challenges:

> "The Board must ensure that the directors and senior management of the (fund), collectively, have the full range of skills needed for the effective and prudent operation of the (fund's) business operations, and that each director has skills that allow them to make an effective contribution to Board deliberations and processes. This includes the requirement for directors, collectively, to have the necessary skills, knowledge and experience to understand the risks of the (fund's) business operations, including its legal and prudential obligations, and to ensure that the (fund's) business operations are managed in an appropriate way taking into account these risks. This does not preclude the Board from supplementing its skills and knowledge by engaging external consultants and experts."

This quote highlights both the large risk management component of Board governance and the critical requirement for "the full range" of relevant skills and experiences to be represented around Board tables. As to the last sentence of the quote, it is understandable that complexity should increase the demand for specialist skills. Several funds are already recruiting specialists to both their management teams and Board Committees dealing with increasingly complex investment, taxation, technology and other matters. Such recruitments, however, do not necessarily reduce the pressures on Boards or their responsibilities: being ultimately responsible and accountable for their fund's activities, Boards collectively – large and small – are obliged to maintain strong skill sets of their own. Larger funds need more directors – and a wider range of skills – on their Boards than smaller funds but all funds need directors who can not only ask the right questions but also can make sense of any complex or "technical" issues raised by specialist advisors (whether within the internal management teams of larger funds or by the external consultants of smaller funds), and reach sound judgments on their implications for members.

Views might differ on how best to deliver the quality and depth of the skills and experience required by funds. The approach favoured here is to directly target and attack specific gaps in Board skill sets, rather than rely on these gaps being met through the blunt ideological instrument of mandating minimum numbers of independent directors on Boards. The focus

in this report is on the “skills” of incoming directors as against their “independence”; in quantitative terms on-going Board actions to address skill gaps in the existing cohort directors through, for example, skill matrix processes, and professional development courses are arguably more important.

Some specific suggestions for enhancing the skill sets of Boards of NFP funds are canvassed below:

(i) Fund Charters. As with “values”, a fund’s charter should emphasise the importance which the Board attaches to relevant skills and experience in generating superior returns to members, and formally record its commitment to maintaining an appropriate mix of skills and experience on the Board at all times.

(ii) “Agreed Skill Experience Profiles” for New Directors. Given their responsibility for monitoring of fund performances and changes in business environments, Boards should be well placed to spot particular gaps (current and prospective) in their collective skill sets. Because of these insights, whenever a director vacancy arose (or a new directorship was created), it would make sense for the whole Board to meet to agree a detailed skill/experience profile tailored to the vacancy in question.

This “Agreed Skill/Experience Profile” would constitute the first step towards filling a director vacancy; it would highlight particular requirements in respect of skills, qualifications and experience, having regard to gaps in the Board’s existing skill matrix, and to possible future pressure points.

(iii) Selection Processes. APRA requires all funds to have “robust” processes for the nomination (and appointment and termination) of directors. Funds are also required to have policies in place to deal with situations where a sponsoring organisation nominates or appoints a director who the Board considers unsuitable for appointment. The suggestions which follow are consistent with “robust” selection processes in pursuit of the best possible mix of skills and experience on the Boards of NFP funds.

In the case of an existing vacancy, where a relevant sponsoring organisation has the opportunity to nominate its candidate (under the equal representation arrangements) to fill

that vacancy its nominee could come from within its own ranks or, if no such suitable nominee was available, it could nominate an "outsider"as its representative director. That appointment would proceed if a majority of the Board agreed the nominee satisfied the skills and values requirements. In the absence of a majority – an unlikely situation if the agreed skills profile and other requirements reflected appropriate consultations and were followed conscientiously – the required disputes resolution policy would be called into play. This might provide for the sponsor organisation to try again, and to try harder.

At the end of the day, if agreement on a nominee could not be reached through these processes, the policy should provide for the Nominations Committee to assess a wider field of candidates (again paying particular attention to the skills and other requirements). The policy should provide the opportunity in such situations for a limited number of representatives of the sponsoring organisations to attend the Nominations Committee's proceedings. While these situations are likely to be rare, it would make sense, as APRA expects, for Boards to have agreed policies in place to deal with them should they occur.

Where a new director position was being created by the Board to fill a particular – and possibly urgent – skill gap, it would seem appropriate to activate the Nominations Committee at the outset, armed with the Board's guidance regarding skills and values. Again the process would be facilitated if the fund's policy was to provide for (limited) representation by interested sponsoring organisations at the Nominations Committee's proceedings.

It seems reasonable to expect that, over time, the demand by industry funds in particular for directors with special skills would outrun the supply available from within their sponsoring organisations. In that event more directors would be recruited – including by the sponsoring organisations themselves – from outside those organisations; some of these directors would likely qualify as "independents" under the current SIS Act definition. This is already happening: currently about 50 directors of industry funds (or closer to 15 per cent) are independents[11]. Industry funds should be able to cope with this evolving situation: the potential pool of skilled and committed people to draw upon will be larger, while the relative attractiveness of the NFP brand might also be expected to appeal to more prospective directors, as it has to members.

It might, however, pose some questions for the "equal representation" model of industry and other NFP funds. As noted earlier, this model provides for equal representation of employees and members in respect of "standard employer-sponsored funds" and is presently guaranteed under the SIS Act. That situation would cease if the repeal provisions in the Government's original Bill were to be adopted. If the changes proposed in the Bill were not adopted the legal underpinnings of the current arrangements would remain. In its November 2016 Guide, APRA expressed the following comment on this status quo position:

> "… APRA's view is that a prudent equal representation board would consider the benefits of the appointment of at least one independent director."

The likely appointment overtime of more directors who might qualify as independents could be viewed as potentially disruptive by some but the overall impact on fund members would be beneficial if it resulted in the best available directors (in terms of skills and values) being appointed to Boards. The recommendations in this report are intended to help deliver that outcome: if NFP funds were to agree to adopt processes along the lines suggested in the report all the sponsoring organisations involved would need to be firmly committed to making them work, even if this caused some disruption of the "pure" equal representation model.

While on the subject of the skills of prospective directors, suggestions are sometimes made that setting some minimum entry qualifications for directors might contribute to better governance outcomes, presumably by making it harder for "rogue operators" to slip through the net. Casual observation, however, does not point to any positive correlation between credentialism and integrity: a lot of skulduggeries are hatched under mortar boards. (This is not to denigrate current efforts to establish appropriate standards of qualification and ethical behaviour in the financial planning industry, which has been crying out for reforms of this kind). So far as directors of NFP funds are concerned, many do have some tertiary qualifications but are generally appointed more for their track records of performance and judgment in relevant fields, than for their qualifications as such.

Effective selection and reference checking processes (incorporating the refinements suggested here) are likely to offer the best protection against serious mistakes occurring in

the appointment of directors. Once appointed, of course, the delivery of high quality induction courses to new directors, (including on their legal and prudential requirements), and the provision of appropriate on-going opportunities and encouragements for them to hone their skills as a Board member are (or should be) major responsibilities of all Boards.

2. Appointment of Board Chairs

The Government is proposing to mandate that the Chairs of all super funds be "independent", presumably in the belief that this aura of independence will help to deliver outcomes beneficial to fund stakeholders. Again, however, it is not clear why this belief should bear fruit for members of NFP funds.

As well as having a good measure of the values and particular skills expected of all directors, Chairs are required to possess some extra qualities. Important among these is the ability to facilitate open and informed debates on many issues, culminating (more often than not) in decisions acceptable to all directors. These extra skills are not easily defined: they can be exercised in different ways or "styles". It is reasonable to believe, however, that from their contacts and interactions at Board meetings over a number of years individual directors would come to discern who among their fellow directors were "Chair material", and who were not. When the time came to appoint a new Chair, directors collectively would have a pretty good idea about who among them was best equipped to lead the Board – and if none of the existing directors was judged to be up to the mark – to advocate an outside appointment. In such matters, considerable weight should be given to the collective Board judgments, and:

- if there was general agreement on a standout candidate in the ranks of current directors that view would be hard to override; but
- if there was no such standout the prudent course would be for the sponsoring organisations to agree processes for recruiting an "outside" Chair.

In the interests of their members, NFP funds should always appoint the best available candidates as Chairs, whether or not they were "independent", and irrespective of any rotational arrangements that might have operated in the past. To the extent that

"independents" were to become more conspicuous on the Boards of NFP funds in the years ahead, this approach means that, at least for those funds, independent directors would obviously be considered for Chairperson (in line with the view expressed in APRA's SPG 510). More over, the chances of selecting the best possible person for the position would be enhanced if the field of candidates were to comprise all the directors, not just the mandated minimum one third envisaged in the Government's proposals.

The appointment of independent directors and Chairs across all superannuation funds is the primary focus of the earlier Bill and, therefore, of this report. As important as these particular aspects of Board Governance are, they represent only part of the very comprehensive governance policies which individual funds are obliged to follow because of legal and regulatory requirements, and through their participation in particular industry codes (such as the ASX and FSC codes – mentioned above – and the AIST Code – see below) Only two elements of these comprehensive policies/codes are touched upon here – Board Renewal and Member Communications.

3. Board Renewal

In their own interests – and those of their members – Boards are required to have policies for "renewing" Boards to stay abreast of changing operational environments. The earlier emphasis on policies to recruit new directors with valuable skills, and to upgrade the skills of existing directors, are obviously relevant here also. Two additional policies worthy of mention, because they can affect the mix of skills and experiences represented around Board tables, relate to tenure and gender balance.

(i) Tenure Policy. This is one of those areas where reasonable discretion is likely to deliver better outcomes than rigid rules, partly because of size and other differences across funds but partly also because it makes sense to extend tenure where a director's continued engagement and contributions were demonstrably valuable to the fund. Boards are required to regularly evaluate the collective and individual performance of directors and, in practical way, all directors are "on show" at every Board meeting. These arrangements provide reasonable opportunities to assess whether or not the contributions of individual

directors were falling off as their terms grew; that can happen but the real possibility of a positive correlation should not be ruled out!

APRA has not quite set a rigid rule but it has indicated its expectation that there would be "limited circumstances" when it would be appropriate for total periods of tenure to exceed 12 years. For the reasons indicated in the previous paragraph, it is recommended that NFP funds should adopt a pragmatic approach to tenure, and be prepared to argue strong cases on occasions for "exceptional circumstances".

(ii) Gender Balance. This issue usually surfaces as part of a fund's "diversity" policy but it is also germane to the need for NFP funds to access the widest possible pools of skills and experience when selecting directors (and staff generally). At present, on average about 1 in 4 directors of industry funds is a woman, with the average higher for larger funds (about 1 in 3) than small funds (about 1 in 5). Some progress has been made over the years but the average numbers remain below the earlier AIST aim of achieving a minimum of 40 percent of each gender on NFP Boards 2017.

The Boards of NFP funds are generally closer to gender balance than corporate Boards but can do better. Conscious and unconscious biases against women on Boards are both unfair and an avoidable constraint on the size of the talent pool accessible to funds. One area where a firm target could help to improve Board governance is gender equality. Differences in the sizes and industry orientations of funds argue against every individual fund quickly achieving equality. But concerted action on the part of each fund could be expected to produce "unders" and "overs", which would make a sector wide target meaningful and achievable. With its new mandatory Governance Code (which has a considerable emphasis on "diversity" policies) expected to be implemented shortly, AIST would seem to be well placed to adopt and monitor such a target – and equal gender representation on Boards on average across the whole NFP sector in 5 years' time would seem a perfectly reasonable and fair target to aim at.

4. Member Communication

Funds communicate with many parties, including regulatory bodies, sponsoring organisations and their members, and on many topics: it is an essential part of being transparent about, and accountable for, what they do. As the funds with the "members first" culture, NFP funds should – and probably do – lead the way in this field.

Some of the larger funds hold "live" meetings where members have opportunities to meet Board members and ask challenging questions. On-line facilities are often attached to these meetings to enable other members to follow the proceedings and to send in questions of their own. The high costs of these "AGM-type" meetings limits their feasibility for smaller funds which tend to focus more on workplace meetings between fund officers and members. All funds report to their members at best annually and often more frequently on fund performances and returns, product and policy innovations and other matters of interest.

Members generally appreciate reports on how their funds are performing – and behaving – relative to other funds. Many would likely be interested also in being better informed about the skills and experience strengths of their Boards, and in having more transparency on the processes for appointing and removing directors, and policies for addressing gender imbalances – all the issues, in short, which it is argued in this report have a substantial bearing on the security and growth of members' retirement savings. To this end the Boards of NFP funds should commit to explicitly addressing governance issues of these kinds in their annual reports to members – and proactively at other times and in other ways (such as member conferences and workplace meetings) as appropriate.

5. Implementation Options

If NFP funds were of a mind to take actions along the line proposed in the recommendations, the question arises as to how they might best commit to doing so. AIST is now close to finalising a new, revamped version of its Code which is intended to promote the highest possible standards of governance across the whole NFP sector.

There is considerable common ground between what is proposed in the present draft of the AIST Code and the recommendations in this report. The Code is dedicated to the NFP sector – what it calls the "profit for member" sector; it is based on "a member first" culture, and emphasises "competence and commitment" in the selection of directors; and it refers throughout to "non-representative" – rather than "independent" – directors, thereby avoiding the definitional uncertainty surrounding the latter description.

The Code is planned to take effect from 1 July 2017. It would be mandatory for AIST member funds, with an obligation for them to report annually to AIST on their compliance (on an "if not why not" basis). AIST also proposes to engage an independent body to review members' compliance with the Code, and to suggest possible amendments to it. AIST's Code is comprehensive in its coverage and goes well beyond the relatively narrow Board governance issues and the targeted recommendations contained in this report but the processes currently underway to finalise the Code represent an appropriate and timely opportunity for NFP funds to consider those particular recommendations.

Reflection of the recommendations in the final version of the AIST Code would be a good outcome. A Code dedicated exclusively to the NFP sector not only highlights the distinctiveness and maturity of that sector (which now represents over 40 percent of the whole superannuation industry): it also represents a clear reaffirmation of the commitment of NFP funds to governance standards intended to protect members' retirement savings.

If for any reason the recommendations in this report were not picked up in the final AIST Code, NFP funds could – if they were so inclined – incorporate them in their individual governance policies as they considered appropriate.

## RECOMMENDATIONS

From their beginnings NFP funds have been decidedly member focussed and, in a relatively short period, have established an enviable reputation for delivering strong performance and quality services to their members. The close collaboration between sponsoring organisations and their Boards has been a major contributor to this success and the development of a unique culture. From their Boards down, they have exhibited consistently

good values (encapsulated in "all profits to members"), a low cost/high value philosophy and competitive skills in managing investment and other risks, all of which have helped to underwrite their reputation. Values, skills and experience are as critical today as ever but maintaining an edge in them is proving more challenging than ever.

The thrust of this report is that Board governance of industry and other not-for-profit funds could best be improved – that is, best help to deliver superior outcomes for members – by continuing to build on their strengths in values and skills, rather than through mandated minimum numbers of independent directors on their Boards. This is what the recommendations of this review seek to achieve, through their reflection in the constitutions of the funds' governing structures, and the Board governance policies of the funds.

The report debates, from the perspective of members of NFP funds, the relative attributes of the mandated independence approach and direct action to strengthen values and skills. It comes out clearly in favour of the latter but does not speculate on how NFP funds might react in the event that the provisions in the re-introduced Bill were adopted.

During the course of the consultations with them, the two major sponsoring organisations for industry funds – AiG and ACTU – indicated broad support for the thrust of the report, without necessarily endorsing all the individual recommendations.

<u>Boards of Directors</u>

1. Members of NFP funds would be best served by strengthening the values, skills and experience of Boards of Directors. To this end, Boards should agree:
   a. Values/Selection Processes
      i. to make clear in their informal "charters" (which APRA will require of all Boards by 1 July 2017) that the unique commitment of NFP funds to their members (encapsulated in "all profits to members") was unshakeable and should be embedded in the fund's processes wherever appropriate (the extent to which such measures – including those which follow – require changes to constitutions will be a matter for each fund to consider)

ii. to require Board Nominations Committees to include a comprehensive assessment of candidates' compatibility with the fund's values when reporting on their suitability as prospective directors
iii. to require newly appointed (and reappointed) directors to confirm in writing at the time of their appointments that they understand the fund's values , are comfortable with them , and see no conflicts with them

b. Skills/Selection Processes
   i. as with "values", to re-enforce in their "charters" the central importance of relevant skills and experiences in generating superior returns to members, and commit to maintaining an appropriate mix of skills and experiences on the Board at all times
   ii. as a first step towards filling a director vacancy, the whole Board should discuss and agree a detailed skill/experience profile tailored to the vacancy in question, having regard to current and prospective gaps in the Board's skill set
   iii. in equal representation funds, where the relevant sponsoring organisation puts forward a nominee to fill a vacancy (either from within its own ranks or from "outside" those ranks) that nominee shall be appointed if a majority of the Board agrees that the nominee satisfies the Agreed Skill Profile (and other relevant requirements)
   iv. policies should be developed (and approved by the Board) to deal with rare but possible situations where the Board and sponsors are unable to reach agreement on the proposed appointment; this should include the Nominations Committee process being activated to assess a wider field of candidates (again paying particular attention to the Agreed Skills Profile), and make its recommendations to the Board
   v. where a new director position has been created to fill a particular - and possibly urgent - gap in the desired skill mix the Nominations Committee process should be activated at the outset, with relevant inputs from the Board in respect of the Agreed Skill Profile, experience and any other requirements
   vi. the Board should have effective processes to liaise as appropriate with sponsoring organisations on these recommendations in respect of values, skills and selection

processes; this should include the opportunity for limited representation of sponsoring organisations at meetings of the Nominations Committee.

Board Chairs

2. In the interests of their members , NFP funds should always appoint the best of the available candidates ( from within the existing Board or , if necessary , from outside ) as Chairs , whether or not that person was " independent " , and irrespective of any previously established rotational arrangements .

Board Renewal

3. All funds are required to have policies for regularly evaluating the performance of Boards, and for "renewing" Boards to stay abreast of changing operational environments. Given the critical role of skills and experience in the performance of NFP funds, Boards of these funds should pay particular attention to renewal policies, including:
   i. "tenure" policy - this is one of those areas where reasonable discretion is likely to deliver better outcomes than rigid rules , partly because of size and other differences across funds but partly also because it makes sense to extend tenure where a director's continued engagement and contributions were demonstrably valuable to the fund; for these reasons Boards should adopt a pragmatic approach to tenure, including a preparedness to argue for extended periods of tenure in “exceptional circumstances”.
   ii. gender balance – one area where a firm target could improve Board Governance is gender equality and AIST should establish and monitor a target to achieve gender equality on Boards across the NFP sector as a whole by mid-2022.

Member Communication

4. As part of their on-going policies to improve communications with members, Boards of NFP funds should commit to addressing a range of Board governance issues in their annual reports to members and at other times and in other ways (such as member conferences and workplace meetings) as appropriate.

Implementation of Recommendations

5. AIST members (who cover the whole of the NFP sector) should give consideration to these recommendations (including 3 (ii) above) in the course of finalising their draft Governance Code.

# Notes

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[1] Bernie Fraser was an independent director of several large industry super funds for approximately 15 years, and the "independent" chair of Members Equity Bank (owned by Industry Super Funds) for a similar period.

He has been the Chair of two independent Australian Government statutory authorities – the Reserve Bank of Australia (7 years) and the Climate Change Authority (3 years).

[2] Public submissions made to the review are available at www.thefraserreview.com – The submissions include comments on the kinds of issues canvassed in this report and have been helpful inputs into it.

[3]Letter of 17th December 2015

Dear Senator,

Good Governance and not-for-profit superannuation funds

You might like to know that the proposed Review of governance arrangements in relation to not-for-profit super funds is now underway.

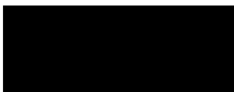
From tomorrow the attached paper will be available online, which briefly outlines the nature of the Review, and invites comments/submissions from interested individuals and organisations. The issues mentioned in the paper pick up many of the thoughts expressed by cross bench senators in relation to this Review. It remains to be seen what this invitation will elicit by way of material responses but we thought it appropriate to provide the opportunity for "interested parties" to participate.

It is expected that the most substantial inputs to the Review will emerge from the rounds of consultations which we plan to initiate with major stakeholders - including of course relevant cross bench Senators - as soon as practicable after Christmas. We will keep you informed of these arrangements and of the progress of the Review more generally. If in the meanwhile you should have any particular queries in relation to this Review please feel free to contact me at any time.

I am writing in similar terms to other relevant cross bench Senators.

Kind regards,

Yours sincerely,



Bernie Fraser

Cc: *Senator Lambie, Senator Lazarus, Senator Madigan, Senator Muir, Senator Wang, Senator Xenophon*

[4] Letter of 17th December 2015

Dear Minister,

Good Governance and not-for-profit superannuation funds

I think you are probably aware of the Review which I have been asked to lead into governance arrangements pertaining to not-for-profit super funds.

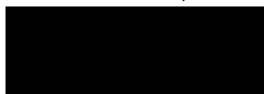
I am writing to inform you that from tomorrow the attached paper will be available online, which briefly outlines the nature of the Review and invites comments/submissions from interested parties. We are not expecting a great deal by way of material responses but we did want to at least provide an opportunity for interested individuals and organisations to participate if they were so inclined.

The most substantial inputs to the Review are likely to emerge during the course of the consultations we are planning to initiate with major stakeholders after the Christmas break. I would like to think that, as those consultations develop and particular positions emerge, you might see your way clear to engage in a general discussion around some of these issues.

I would like to pursue this possibility with you a little further down the track.

Kind regards,

Yours sincerely,



Bernie Fraser

[5] The review committee met with an Expert Panel comprising of Professor Gordon Clark – a Governance and investment academic based in the UK with postings in the UK, US and Australia, Mila Justine Hoekstra – Author of the Code of the Dutch Pension Funds and secretary of the Monitoring Committee that oversees compliance with the Code, Claire Keating – Long-serving partner at PwC with extensive experience in financial services and governance, Chris Lovell – Chairman of Holding Redlich with extensive experience in corporate governance. The panel discussed best-practice governance of Australian and overseas superannuation and pension funds. While not

opposed to appointing independent directors, the broad view of the panel was that appointing independent directors was not an end in itself, but needed to be considered in a broader context and undertaken with specific purpose.

[6] Letter of 3rd May 2016

Dear Senator

Re: Board Governance of Not For Profit Funds

As you know, over recent months we have been consulting with relevant stakeholders to develop an appropriate governance code for boards of not for profit superannuation funds.

This work is quite well advanced but, in the light of the upcoming election, I think it makes sense to defer our envisaged further discussions until that election is out of the way.

I look forward to resuming our discussions on governance arrangements for not for profit funds that will best promote and protect the interests of members of those funds after the election.

Kind regards,

Yours sincerely,

Bernie Fraser

Cc: *The Hon Adam Bandt, The Hon Jim Chalmers, Peter Kell - ASIC, Senator Lambie, Senator Lazarus, Senator Madigan, Greg Medcraft - ASIC, Senator Muir, Helen Rowell – APRA, The Hon Bill Shorten, Pauline Vamos - ASFA, Senator Wang, Senator Whish-Wilson, Senator Xenophon*

[7] The key performance indicators for bonus payments to senior executives are very heavily weighted to outcomes which also increase shareholders' wealth (such as increases in profits and in share prices); if they exist at all, measures of customers' satisfaction and trust receive very modest weights

[8] Kelly O'Dwyer, Speech to Industry Super Australia Conference, 22 November 2016 http://kmo.ministers.treasury.gov.au/speech/017-2016/ The brief quote includes the curious phrase "under the law" which is open to different interpretations, none of which helps the case that the governance standards of banks and life offices (whether "under the law" or in practice) should be the benchmark for superannuation funds.

[9] ISA analysis of SuperRatings Fund Crediting Rate Survey, December 2016

[10] *See for example, the speech by Mike Carney, Governor of the Bank of England in the court room of the Bank of England, 30 June 2016*

[11] ISA estimates that about 50 directors of industry super funds currently satisfy the SIS definition and are called "independents" by the funds involved. ISA also estimates that at least this number of "represented" directors of industry funds would also qualify as "independents" if the relevant tests were applied to them.

# Attachment 3

# AIST Board Governance

# AIST Governance Code

# 2017

AUSTRALIAN INSTITUTE of SUPERANNUATION TRUSTEES

## *Foreword*

The profit-to-member superannuation sector stands proudly by our record of achieving superior net returns on the retirement savings of our members. We have achieved this as a fundamental expression of our members-first culture, built on our equal representation governance structure.

Nevertheless, as our industry grows and changes, there is a collective need for us to review the way we govern ourselves, to preserve those good things that distinguish us and to further develop those areas where we can improve.

The AIST Fund Governance Code has grown out of such a review. Based on the ASX Corporate Governance Principles and drawing both on AIST's voluntary Fund Governance Framework first published in 2011 and on widespread consultation with our members, AIST has developed a Code that recognises the complexities of super fund governance today and positions us well for the future.

AIST member funds can choose to adopt the Code from 1 July 2017, and must adopt the Code by 1 July 2018. An independent panel will report back to AIST on the extent to which member funds meet all the requirements, or provide reasonable explanation of why it was not possible, or would not be in member interests, if they were to meet them.

AIST is committed to promoting continuous improvement in governance practices in the profit-to-member sector. We are confident that our member funds share our vision and will continue to embrace governance practices that place their members' interests at the centre of everything the fund undertakes.

**David Smith**
President
Australian Institute of Superannuation Trustees

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Enquiries can be sent to AIST at **info@aist.asn.au** or **(03) 8677 3800.**

# Introduction

The compulsory nature of our superannuation system, together with its size and significance in Australian public policy, means it is imperative that superannuation funds implement and maintain the highest standards of governance.

AIST is committed to the highest standards of governance in the profit-to-member superannuation sector and to a culture of continuous improvement in governance practices. This Code and the accompanying Guidance were developed to build on AIST's set of guidelines and principles for good governance in the industry – the *Fund Governance Framework for Not-for-Profit Superannuation Funds* – that was first published in 2011 and is now in its third edition

This Governance Code however reflects the increasing attention devoted to superannuation governance matters, the advanced maturity of the industry and the importance of safeguarding and growing members' retirement savings through robust governance practices, thereby evolving a voluntary set of principles into a mandatory Code for AIST registered funds.

All AIST registered funds must demonstrate how they have fulfilled each requirement set out in the Code, or provide a reasonable explanation of why it was not possible to comply, or why it would not be in the interests of members of the fund if they were to comply.

This Code will:

- Promote continuously improving governance in the profit-to-member super sector
- Ensure that the culture of the profits-to-members concept is fully supported by governance structures
- Improve accountability and transparency

The Code is to be read in the context of existing licensing, prudential and legislative requirements imposed on the superannuation industry. Where a conflict exists between the law and the elements of this Code the law shall prevail and the Code elements are invalid to the extent of the inconsistency. **Appendix A** sets out the main legal and regulatory requirements for superannuation funds.[1]

The rights of superannuation fund members and beneficiaries are protected through the augmented trust law structure within which the Australian retirement savings system operates. The fiduciary nature of trustees' obligations is such that the trustees' discretionary powers are limited by the terms of the governing rules of the fund and duties are assigned to specifically protect the interests of scheme beneficiaries.

In addition to the existing legal and regulatory requirements on Australia's superannuation funds, a continuous focus on safeguarding and growing members' retirement savings, and increasing accountability and transparency can be achieved through a range of measures set out in this Code.

The AIST Governance Code does not cover consideration of ESG risks and stewardship of fund members' assets. AIST is considering the development of a Stewardship Code separately from the Governance Code and members will be consulted on its scope and content.

1. Not including exempt public sector funds that each have their own legislative requirements.

# Code elements

## PRINCIPLE 1: Lay solid foundations for management and oversight

A profit-to-member superannuation fund must determine the respective roles and necessary skill profile of the Board and management and set these out in writing. They must also determine how the respective performance of the Board and management will be measured and evaluated.

### REQUIREMENTS

**1.1** A profit-to-member superannuation Board must conduct all appropriate enquiries to ensure that nominees have the appropriate skills and experience before appointing a person as a trustee director. For the appointment of representative directors in particular, this includes engagement with sponsoring organisations.

**1.2** A profit-to-member superannuation fund must have a written agreement with each trustee director and senior executive setting out the terms of their appointment.

**1.3** The fund's company secretary is accountable directly to the Board, through the Chair, on all matters concerning effective Board operations and must provide every assistance to the Board to fulfil their obligations in acting in the best interests of members. The Chief Executive Officer must not be the company secretary.

**1.4** Profit-to-member superannuation funds must have a written diversity policy, appropriate to the circumstances of the fund, which sets out clear and measurable objectives and provides for annual reporting to the Board and members. This policy must establish objectives concerning gender balance as a minimum, with other forms of diversity considered by the fund as appropriate. Objectives must relate to processes, which may, but do not necessarily, include targets for participation at Board and management levels, to ensure that the fund taps the broadest talent pool and is responsive to the needs of all its members.

**1.5** In accordance with SPS 510, profit-to-member superannuation funds must have procedures to evaluate the performance of the Board and individual trustee directors at least annually. The fund must disclose a summary of those procedures and confirm annually that the performance evaluations were undertaken during the reporting period.

**1.6** The Board of a profit-to-member superannuation fund must have a documented process for evaluating the performance of the senior management. The fund should disclose whether such a performance evaluation was undertaken during the reporting period.

## PRINCIPLE 2: Structure the Board to add value

A profit-to-member superannuation fund must have a diverse Board composed of highly competent and committed directors. Representation of member and employer interests must be ensured, and the Board should be of an appropriate size, composition and have the skills to be able to discharge their duties effectively.

### REQUIREMENTS

**2.1** The Board of a profit-to-member superannuation fund must have a committee responsible for Board renewal that has at least three members. The committee must have a charter that is disclosed and it should meet at least annually. For each reporting period the fund must disclose the members of the Board renewal committee and attendance records for any meetings during that period.

**2.2** A profit-to-member superannuation fund must maintain a matrix showing the skills, relevant experience and diversity the Board currently has and acknowledge gaps it is looking to fill in order to effectively fulfil its strategic plan. It must disclose annually a representation of the existing collective skills, experience and diversity of the Board.

**2.3** In disclosing the names of its directors, a profit-to-member superannuation fund must identify for each director whether they are a member representative, an employer representative or a non-representative member. In each instance, the name of the nominating body must also be disclosed.

**2.4** The voting rights of all trustee directors on the Board must be equal, regardless of their status as a member or employer representative director, or non-representative director. The voting majority for any Board decision should be no less than two-thirds of all trustee directors.

**2.5** The Chair of a profit-to-member superannuation fund Board must be appointed by the Board, and must satisfy all the requirements of skill and experience identified in the fund's skills matrix for the role of Chair.

**2.6** The CEO must not be a director of the fund.

**2.7** A profit-to-member fund must have an induction program for new trustee directors and provide appropriate ongoing professional development and training opportunities to continuously enhance their skills and knowledge.

## PRINCIPLE 3: Act ethically and responsibly

A profit-to-member superannuation fund must act ethically and responsibly.

### REQUIREMENTS

**3.1** A profit-to-member superannuation fund must have a code of conduct for its Board, senior management and employees. This code, or a summary of it, must be disclosed.

## PRINCIPLE 4: Safeguard financial integrity

A profit-to-member superannuation fund must have appropriate and rigorous processes for financial governance.

### REQUIREMENTS

**4.1** The Board of a profit-to-member superannuation fund must ensure the financial integrity of both the fund and the trustee entity.

**4.2** A profit-to-member superannuation fund must ensure due process in all transactions, and ensure that any related party transactions are conducted under market conditions with full transparency and disclosure.

**4.3** The Board of a profit-to-member superannuation fund must receive an attestation from the fund's CEO and CFO that the fund's accounts are a true and accurate reflection of the fund's financial position and that the financial records have been properly maintained, before approving the financial statements. In accordance with SPS 510 an independent auditor must be appointed. The auditor must be fit and proper pursuant to SPS 520 and must issue their opinion on the financial statements to the trustee and members of the fund.

## PRINCIPLE 5: Respect the rights of scheme participants

A profit-to-member superannuation fund must respect the rights of stakeholders. These scheme participants must be provided with open and transparent disclosure as well as opportunities to participate in dialogue with the fund's Board and management.

### REQUIREMENTS

**5.1** A profit-to-member superannuation fund must develop and implement a stakeholder engagement program, for effective disclosure of relevant and material issues. The program must provide opportunities for directors and senior management to communicate directly with stakeholders and for stakeholders to ask questions of them.

## PRINCIPLE 6: Recognise and manage risk

In accordance with SPS 220, a profit-to-member superannuation fund must establish a robust risk management framework, monitor and regularly review the effectiveness and continuing appropriateness of that framework. The risk management framework must consider the maintenance and prioritisation of a member-first culture.

### REQUIREMENTS

**6.1** A profit-to-member superannuation fund must have a strong risk culture with a Board that provides robust oversight of the fund's material risks. The risk management framework must explicitly address factors that may erode the fund's members-first culture.

## PRINCIPLE 7: Remunerate fairly and responsibly

A profit-to-member superannuation fund must establish a remuneration policy for its trustee directors and staff in alignment with the best interests of the members of the fund that complies with SPS 510 and SPG 511.

### REQUIREMENTS

**7.1** A profit-to-member superannuation fund must have policies and practices in place to attract and retain highly competent people, assessed relative to the size, nature and complexity of the fund. These policies and practices must be consistent with its responsibilities for maximising members' retirement outcomes and encouraging and rewarding ethical practices and behaviour.

## PRINCIPLE 8: Strong investment governance practices

A profit-to-member superannuation fund must establish an investment framework to deliver appropriate retirement outcomes for its members and continually monitor and review the effectiveness and continuing appropriateness of that framework.

### REQUIREMENTS

**8.1** A profit-to-member superannuation fund must design and manage appropriate investment strategies having regard to member demographics and circumstances during both the accumulation and decumulation phases.

# Reporting and monitoring

## WHO MUST REPORT AGAINST THIS GOVERNANCE CODE?

AIST registered funds include industry funds, public sector funds and corporate funds – all run on a profit-to-members basis. AIST acknowledges the differences that exist in the structure, size and complexity of its registered funds, and recognises that exempt public sector funds' operating parameters are established by Acts of Parliament.

Reporting against the Code is on an 'if not, why not' basis. Compliance is measured against the 21 listed requirements. These reporting requirements are complementary to the funds' reporting obligations to APRA, ASIC and other authorities.

This Governance Code applies to all registered funds of AIST.

AIST recognises that for some funds, the existing governing rules may constrain compliance. Where possible, AIST expects that fund Boards would negotiate with key stakeholders to secure changes in the governing rules to facilitate compliance.

AIST acknowledges the additional constraints experienced by funds, whose governing rules are established in legislation where that legislation and supporting regulations impose restrictions on their ability to comply with the Governance Code. AIST requires registered funds so affected to fulfil the Code requirements where possible within the parameters of their legislative framework, and use the 'if not, why not' reporting framework to explain any deviations from the principles. Deviations resulting from over-riding legislative requirements will not draw adverse comment for the purpose of this Code.

## REPORTING AGAINST THE CODE

The Governance Code requires the Boards of AIST registered funds to turn their minds to the principles and accompanying requirements in the Code and consider how compliance with and the application of each principle best achieves outcomes in the best interests of their members. Funds should consider the requirements for achieving each principle and then report, on an annual basis, on compliance with the Code. It is desirable that funds make their reporting about the Code publicly available either in their annual reports or on the relevant governance pages of their websites.

It is possible to deviate from the stated requirements, provided the registered fund Board has had appropriate dialogue about the matter, considered the appropriateness of its alternative approach and the suitability of that alternate methodology for its particular circumstances. This process allows funds space for individual responsibility in respect of the policy choices they make in the areas covered by this Code.

AIST recognises that there may be a good reason an AIST registered fund is not compliant with a particular requirement of this Code. The 'if not, why not' reporting framework upon which this Code is based anticipates this. It requires that in these situations, funds should acknowledge and draw attention to any specific areas of non-compliance and provide reasons for the divergence. This is transparent and invites discussion or further consideration in relation to the reasonableness of any such departures from the Code.

Public sector funds that are unable to comply due to their legislative constraints should report their inability against the relevant requirements in this Code.

## MONITORING MEMBER COMPLIANCE WITH THE CODE, AND REVIEW OF THE CODE PRINCIPLES

An independent body will review registered funds' compliance with the Code and make recommendations to AIST on areas where further guidance might be warranted, or where the principles might require amendment.

AIST's Governance Code will be reviewed on a three-yearly basis, in consultation with AIST members.

# Appendix A

## MAIN LEGAL REQUIREMENTS FOR SUPERANNUATION FUNDS

The information in this part:

— Excludes public sector superannuation schemes that are exempt from regulation under The *Superannuation Industry (Supervision) Act 1993.*

— Does not cover the requirements placed on various superannuation fund service providers such as auditors, insurers, administrators and custodians.

**Table 1: Regulators and government bodies with responsibility for superannuation**

| REGULATORS AND GOVERNMENT BODIES | |
|---|---|
| Australian Securities and Investments Commission (ASIC) | Ensures fair play in business, promotes market integrity, consumer and investor protection, disclosure, and prevents corporate crime. Functions include licensing of financial service providers, enforcement, and administering the *Corporations Act 2001.* |
| Australian Prudential Regulation Authority (APRA) | Prudential regulator. Administers aspects of *Superannuation Industry (Supervision) Act 1993*, promotes prudent management of superannuation funds and ensures trustees are aware of their obligations to members. Has a strong focus on the financial stability of funds. |
| Australian Taxation Office (ATO) | Collects superannuation tax, administers the Superannuation Guarantee legislation and receives returns and reports from funds. |
| Australian Transaction Reports and Analysis Centre (AUSTRAC) | Oversees compliance with the *Financial Transactions Reports Act 1988* and the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006*. |
| Office of the Australian Information Commissioner | Administers the *Privacy Act 1988* and seeks to ensure that trustees collect, store and use member information appropriately. |
| Australian Competition and Consumer Commission | Ensures conduct in the sale or distribution of financial products to retail clients does not contravene the *Competition and Consumer Act 2010.* |
| Superannuation Complaints Tribunal | Hears complaints from fund members regarding trustee decisions. |
| Department of Human Services | Responsible for administering applications for early release of benefits on compassionate grounds. |

### Table 2: Existing legal requirements related to fund governance

| ***SUPERANNUATION INDUSTRY (SUPERVISION) ACT 1993*** | |
|---|---|
| **Relevant subject matter and obligations** | **Relationship with governance** |
| — Prudent management of superannuation funds<br>— Sets roles of regulators<br>— RSE registration & licensing<br>— MySuper authorisation<br>— Establishes fund and service provider audit and reporting obligations<br>— Sets out civil and criminal consequences for contravention of provisions<br>— Establishes monitoring and investigation powers for regulators | — *Operating Standards:*<br>Allows for regulations to be made that set operating standards for funds, which can affect, amongst other things, the composition of the Board.<br>— *Prudential Standards:*<br>Gives APRA the power to set prudential standards affecting the way funds conduct themselves. There are currently 14 standards.<br>— *Governing rules and covenants:*<br>Sets out the covenants that are taken to be included in the governing rules – effectively establishing what trustees must have regard to when operating a fund.<br>— *Equal representation:*<br>Contains rules on Board equal representation.<br>— *Trustee duties:*<br>Codifies special trustee duties that must be adhered to.<br>— *Disqualification and suspension:*<br>Gives power to the regulator to disqualify individuals from serving on trustee Boards, and to suspend the trustee as a whole.<br>— *Successor fund:*<br>Rules for transferring the members and assets of a fund from one trustee to another.<br>— *Notifying APRA and ASIC:*<br>Obligation to report likely/actual significant breaches of prudential standards to APRA and other breaches to ASIC if relevant. Also requires funds to notify APRA following defined events.<br>— *Appointment, removal and information about directors:*<br>Obligation to establish procedures for director appointment and removal, informing members of procedure, and reporting to APRA. Prohibits appointment of disqualified persons.<br>— *Responsible officers:*<br>Obligation to notify APRA of changes to composition of RSE licensee, including directors.<br>— *Reserves strategy:*<br>Obligation for trustee to formulate a strategy to manage the financial reserves of the fund.<br>— *Trustee duties when investing:*<br>Establishes investment duties, including arm's length contracting, borrowing, valuation of assets, monitoring, and due diligence.<br>— *Trustee records:*<br>Imposes requirements to keep up-to-date records, including Board minutes and changes of directors.<br>— *Trustee insurance:*<br>Imposes limits on director indemnification.<br>— *Sole purpose test*<br>— *Disclosure of conflicts of interest*<br>— *Outsourcing:*<br>Trustee requirements when dealing with custodians and investment managers and contains broader outsourcing requirements. |

| ***SUPERANNUATION INDUSTRY (SUPERVISION) REGULATIONS 1994*** | |
|---|---|
| **Relevant subject matter and obligations** | **Relationship with governance** |
| — Addresses various technical matters, such as annuities, pensions, fund classification and payment of benefits<br>— Financial management of funds<br>— MySuper product requirements<br>— Disclosure to regulator and members<br>— Retirement income, eg account based pensions, transition to retirement | — *Operating standards:*<br>Imposes obligations on trustees on various matters, including permissible types of member insurance, voting rules, and investment strategies.<br>— *Rules affecting the governing rules*<br>— *Majority requirements for trustee resolutions* |

| ***THE CORPORATIONS ACT 2001* AND *CORPORATIONS REGULATIONS 2001*** | |
|---|---|
| **Relevant subject matter and obligations** | **Relationship with governance** |
| — Trustee corporation requirements<br>— Sets out regulatory regime for financial products and their providers – including disclosure, licensing, and conduct of superannuation entities<br>— Financial product/services disclosure requirements, including: preparation, content, and issuing of product disclosure statements and financial service guides and other documents<br>— Registration of trustee company<br>— Financial reporting obligations and audits<br>— Appointment and removal of auditors<br>— Market misconduct penalties<br>— Record keeping<br>— Reporting to members and ASIC<br>— Insurance<br>— Australian Financial Services license conditions<br>— Provision of member statements<br>— Obligations with regard to arrangements under the *Family Law Act* 1975 | — *Director duties:*<br>Sets out the legal duties of directors, including disclosure obligations to manage conflicts of interest.<br>— *Director powers and meetings:*<br>Sets out powers of directors and meeting mechanics (subject to the constitution).<br>— *Appointment and resignation of directors:*<br>Rules around appointment, eligibility, resignation and retirement of directors.<br>— *Internal management of company:*<br>Replaceable rules and constitution.<br>— *Director liability and offences*<br>— *Member reporting and content of reports:*<br>Annual reports, transaction confirmations, significant event notices, periodic benefit statements, disclosure statements.<br>— *Professional indemnity insurance:*<br>Prohibition on insurance to cover directors in certain circumstances.<br>— *Disclosure of Conflicts of Interest*<br>— *ASF licence conditions:*<br>Obliges trustees to manage conflict of interests, appoint managers of good fame and character and to monitor authorised representatives. |

| ***FAMILY LAW ACT 1975* AND *FAMILY LAW (SUPERANNUATION) REGULATIONS 2001*** | |
|---|---|
| **Relevant subject matter and obligations** | **Relationship with governance** |
| — Allows for certain payments in respect of a superannuation interest to be allocated between the parties to a marriage, either by agreement or court order<br>— The regulations address splittable and non-splittable payments | — The splitting provisions override provisions contained in the fund's trust deed<br>— Obliges trustee to comply with Family Law requirements |

| ***SUPERANNUATION (UNCLAIMED MONEY AND LOST MEMBERS) ACT 1999* AND *SUPERANNUATION (UNCLAIMED MONEY AND LOST MEMBERS) REGULATIONS 1999*** | |
|---|---|
| **Relevant subject matter and obligations** | **Relationship with governance** |
| — Keeping a register of members' unclaimed money, lost member accounts, and superannuation of former temporary residents<br>— Matching of unclaimed money (including superannuation of former temporary residents) and lost member accounts to persons entitled to receive it | — Sets out procedure for funds to deal with unclaimed money, lost member accounts and superannuation of former temporary residents |

| GENERAL LAW | |
|---|---|
| **Subject matter** | **Relationship with governance** |
| — Common law<br>— Trust Law | — Trustees are required to comply with the governing rules (including trust deed), avoid conflicts of interest, hold assets appropriately, act in best interests of beneficiaries, keep proper records and accounts, act prudently regarding investment decisions |

**Table 3: Existing legal requirements related to funds generally**

| ASIC LEGISLATIVE INSTRUMENTS |
|---|
| — From time to time ASIC issues legislative instruments (Class Orders) to clarify the operation of legislative provisions or to exempt funds/persons from certain provisions of Acts administered by ASIC |
| ***SUPERANNUATION (RESOLUTION OF COMPLAINTS) ACT 1993* AND *SUPERANNUATION (RESOLUTION OF COMPLAINTS) REGULATIONS 1994*** |
| — Establishes a scheme for resolution of complaints of members and beneficiaries of regulated superannuation funds, approved deposit funds and holders of RSAs |
| ***SUPERANNUATION GUARANTEE (ADMINISTRATION) ACT 1992* AND *SUPERANNUATION GUARANTEE (ADMINISTRATION) REGULATIONS 1993*** |
| — Requires employers to pay superannuation or pay the superannuation guarantee charge<br>— Contains choice of fund requirements, such as which funds can be eligible choice funds |
| ***INCOME TAX ASSESSMENT ACT 1997* AND *INCOME TAX ASSESSMENT REGULATIONS 1997*** |
| — Taxation of superannuation entities<br>— Taxation of member benefits, including death benefits, paid by superannuation funds<br>— Early release |
| ***ASIC DERIVATIVE TRANSACTION RULES (REPORTING) 2013*** |
| — Contains requirements for counterparties to report derivative transaction and position information to derivative trade repositories |
| ***PRIVACY ACT 1988*** |
| — Provisions operate to ensure trustees collect, store and use personal information of members appropriately |
| ***AUSTRALIAN ACCOUNTING STANDARD AASB 1056*** |
| — Specifies requirements for superannuation entities 'general purpose financial statements' to provide users with information useful for decision making in a superannuation entity context |
| ***FINANCIAL SECTOR (COLLECTION OF DATA) ACT 2001*** |
| — Enables APRA to collect information for the purpose of assisting it in performance of its functions, publish information, support other agencies and to assist the Minister to formulate financial policy<br>— APRA can set reporting standards and impose requirements to provide documents<br>— Fund reporting requirements |
| ***ANTI-MONEY LAUNDERING AND COUNTER-TERRORISM FINANCING ACT 2006* AND *RULES*** |
| — Imposes obligations on reporting entities (funds), including: registration with AUSTRAC, identification of members and other due diligence procedures, internal record keeping, establishment of an AML/CTF program and reporting to AUSTRAC |

| ***COMPETITION AND CONSUMER ACT 2010 AND COMPETITION AND CONSUMER REGULATIONS 2010*** |
| --- |
| — Provisions promote competition and fair trading within Australian markets and provide for significant consumer protection<br>— Establishes the ACCC<br>— Prevents restrictive trade practices such as price-fixing, restricting outputs in the production and supply chains, allocating customers, and bid rigging by competitors<br>— Prevents misleading and deceptive conduct<br>— Provides for enforcement mechanisms and avenues for remedy |
| ***TAXATION ADMINISTRATION ACT 1953* AND *TAXATION ADMINISTRATION REGULATIONS 1976*** |
| — Taxation of benefits<br>— Requirements to provide information following specified events |

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