MENZIES
RESEARCH CENTRE

28 September 2017

Committee Secretary
Senate Standing Committees on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

via email to: economics.sen@aph.gov.au

Dear Committee Secretary

Re: Governance, Accountability and Member Outcomes in Superannuation

The Menzies Research Centre welcomes the request for submissions in response to the Senate Inquiry into the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017* and *the Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017*.

The proposed legislation has simple objectives that are supported by the Menzies Research Centre, to improve the governance and transparency of all superannuation funds.

Almost $1.5 trillion of Australia's superannuation assets are professionally managed by the superannuation industry, not by individuals. It is critically important that this money is appropriately managed and protected so individuals have the best shot at retirement, and for the added reasons that any failure to maximise retirement saving will ultimately fall back on the government through the aged pension.

Increased transparency as proposed, although welcome, is not enough to ensure the security of Australia's retirement savings. Fund's must be accountable, and the Government is right to re-introduce measures to mandate a third of independent directors and an independent chair on superannuation fund boards.

The 'principal-agent relationship' theory encapsulates the risks to individual investors when their interests are at odds with those of the people managing their investment. The separation of ownership and control can introduce conflicts between the outsiders (the owners) and insiders (those in control).

These agency conflicts are accentuated by information asymmetries, that is there being an imbalance in knowledge between insiders and the outsiders. For the superannuation industry, this imbalance favours superannuation fund insiders and their service providers. Without effective governance and transparency, superannuation fund boards will continue to amplify the risks to members' money, and the Government which ultimately holds the residual risk.

Conflicts may result in insufficient attention to their members' objectives, such as the failure to appropriately monitor staff. They might result in extravagant investments in pet projects through unnecessary advertising campaigns, or investments in non-core business. There is an increased likelihood of entrenchment strategies, such as, investing in underperforming or old systems that only they can run. They may include self-dealing, such as the sponsorship of corporate boxes at sports stadiums, the financing of political parties or contracts written with friends or associates on non-commercial terms.

These conflicts of interest are meant to be mitigated by the fund's board of directors which has statutory and fiduciary duties to act in the members best interest, and appropriate transparency. But how can this governance mechanism effectively operate when according to APRA statistics only 6.9 per cent of just over a thousand directorships on superannuation fund boards were independent.

Those who argue against improved standards of governance usually convey three main arguments.

First, they note that if their funds returns are 'superior' then changing their governance structure will ruin returns in the future. But there is no empirical evidence to support such a claim in terms of the effects of changed governance on investment returns. APRA has consistently noted that the high level, whole of fund performance claims, such as those propagated by the industry fund lobby Industry Super Australia, are misrepresenting the actual underlying performance when compared to age cohorts, member options, and underlying investment objectives. Simple averages across groups of funds are false benchmarks – individual performance is what counts.

Second, there is a claim that this model represents workers best because there are employee representatives on the fund. Such reasoning is outdated, particularly because many funds are now open offer funds – meaning they aren't linked to a particular workforce. Further, with an aging population the superannuation system hasn't even yet matured. When it does, without independent directors on superannuation fund boards, who will represent the interest of members in retirement? But more importantly, what evidence is there to suggest independent directors would not represent all member interests appropriately?

Finally, those arguing against these forms commonly suggest the new governance structure will be more expensive. In fact, non-profit superannuation trustee boards are among, if not the most expensive in the industry as a group. Public not-for-profit and industry funds make up 88 per cent of the top quartile of most expensive superannuation fund board.

The overall cost of running a board is determined by the size of board, and union-controlled funds consistently have larger boards than others for no apparent reason.

Our analysis of APRA trustee data for 2016 notes that:

- 28 out of the 32 most expensive quartile of superannuation trustee boards in the country are public not-for profit and industry superannuation fund trustee boards;
- Of the 39 super fund boards with more than eight directors, only one is a retail fund;
- There is no causal relationship between board size and performance, there is however a relationship between a lack of independent directors and larger boards and higher total board fees; and
- If board size for the most expensive fee quartile of funds reduced to a maximum of 7, superannuation savers in these funds would save a combined $14.5 million in trustee director fees annually.

If superannuation fund boards can't control their own expenses, how can we expect them to control other much larger expenses such as the fees charged for outsourced services or to ensure that money is spent for the benefit of members.

The arguments in favour of the status quo are flimsy at best and duplicitous at worst. Those who propagate them have a clearly vested interest in maintaining control of lucrative organisations established on the back of ordinary workers' savings.

The mandatory appointment of independent directors will allow funds to balance the experience and skills required to deliver sound governance and give members confidence that their life-savings are in safe hands.

I also attach independent research recently published by the Menzies Research Centre assessing the case for independent directors, and concluding in favour this proposal.

Please don't hesitate to contact me should you require any additional information.

Regards

[redacted]

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