Senate Select Committee on Superannuation and Financial Services

Main Inquiry
Reference (a) + (c)

Submission No. 3

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SUBMISSION NO. 3

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RECEIVED
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SENATE SELECT
COMMITTEE ON
SUPERANNUATION

24.12.1999

The Secretary
Senate Select Committee on Superannuation and Financial Services
The Senate,
Parliament House,
Canberra ACT 2600
AUSTRALIA

Dear Sir/Madam,

Please find enclosed a submission to the above committee. My submission deals with:

- Prudential supervision
- Consumer protection for superannuation
- Enforcement of the Superannuation Guarantee Charge

I am keen to be further involved in improving Australia's superannuation system.

Regards,

Dan Scheiwe

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Submission to the Senate Select Committee on Superannuation and Financial Services

Relevant terms of reference of the committee

The following relevant terms of reference were extracted from the senate committees' web page:

....

2) The committee [will] inquire into matters pertaining to superannuation and financial services referred to it by the Senate and inquire initially into:

(a) prudential supervision and consumer protection for superannuation, banking and financial services;

(b) the opportunities and constraints for Australia to become a centre for the provision of global financial services; and

(c) enforcement of the Superannuation Guarantee Charge;

Deadline for submissions

7.1.2000

Relevance and summary of this submission

Australia's system for regulating the superannuation industry is a shambles. The so-called prudential safeguards are a farce and consequently:

- individuals will continue to derive sub-optimal retirement benefits
- the government's retirement incomes policy will fail with the result that substantially increased taxes will be necessary to support our ageing population
- the sub-optimal performance of the superannuation industry will increasingly adversely affect the economy in general

This may seem incredible and many sources will strongly reject these criticisms of Australia's industry. On the other hand others clearly agree, one source climbing that regulatory capture has occurred ie. those whom legislators are supposed to regulate are in fact simply writing the rules to suit the industry, not to protect superannuants and achieve national retirement income objectives. This has probably come about because:

(a) the superannuation industry is well organised and speaks with many voices eg. the Association of Superannuation Funds of Australia (ASFA), the Australian Institute of Superannuation Trustees (AIST), the Institute of Actuaries in Australia (IAA), etc. However, those working in the superannuation industry have one perspective on how it should operate and unfortunately that is the view that had predominated to date.

(b) Unfortunately there is no strong voice for members of superannuation funds and so, as this submission shows, they are treated extremely poorly.

(c) Superannuation is complex and so most fund members don't understand the system and don't know whether they are "getting a good deal" from their fund. They are forced to rely on blind faith

(d) Legislators are very busy people and do not have superannuation expertise. It is not surprising that most of them appear to have relied too much on advice given to them by the superannuation industry, and been overwhelmed by the organised voices from within the superannuation industry. The result is that Australia still has a very bad system for regulating its superannuation industry.

The first of the papers in this submission is a tentative exploration of paradigms of superannuation. It is important that legislators and others appreciate the different perspectives on superannuation in order that they make sound decisions fro relevant legislation. To date relevant legislation reflects only one (outdated) perspective on superannuation.

The table below contains a series of assertions relevant to the terms of reference of this inquiry. These assertions are discussed in detail in a series of papers which constitute the bulk of this submission. Also included are (a) a case study which exemplifies the parlous state of Australian superannuation, and (b) a survey sent to superannuants, and their responses (c) a series of recommendations regarding reform of Australia's superannuation industry.

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Assertion	Attachment #	Attachment title
The complexity of superannuation is compounded by there being different paradigms of superannuation and an imbalance between the lobbying activities of those who support the different paradigms	A	Tentative paradigms of superannuation.
The deficiencies in Australia's superannuation system are such that major fundamental reforms are essential	B	"Why Australia's pension system is not a good international model.", Discussion Paper 12/99, **The Pensions Institute**, London.
Australia's superannuation law does not match its system for regulating that industry and so there is no proper monitoring of the industry	C	"Superannuants needn't be treated worse than shareholders", **Queensland Economic Forecasts and Business Review**, October 1999, pp.62 – 83.
There is no justification for treating superannuants worse than shareholders	D	"Superannuation – a second rate sector?", **JASSA**, Spring 1999, pp. 15 - 18.
The prudential safeguards are a farce and permit many traditional scams to continue	E	"Why Australia's benefit protection legislation is a Farce", **Australian Superannuation Law Bulletin**, May, 1999 (pp.101 - 105)
Many employees are not obtaining proper (if any) superannuation guarantee benefits	F	"Should employers have equal representation on superannuation trustee boards?" **Australian Superannuation Law Bulletin**, March 1997 pp.68-72.
Many fund trustees are accountable to no one	See above	See above
Despite a raft of relevant legislation, it is highly probable that many Australian superannuants are being misled deliberately by information disseminated by fund trustees	G	"Member choice and superannuation reporting", **Australian Superannuation Law Bulletin**, December 1997, pp.37-46.
Many superannuants are being cheated by their own superannuation fund	H	"Are funded defined benefit plans fundamentally a fraud?", **Australian Superannuation Law Bulletin**, November 1996 pp.34 –35
Unlimited choice of fund is	I	Superannuation: negligence and the

essential to avoid highly damaging litigation against employers		employer sponsor
Unlimited choice of fund is essential to avoid highly damaging litigation against unions	J	Superannuation: negligence and the industrial union
An illustrative case study	K	University superannuation: a case study in Australia's appalling superannuation system
Extracts from a superannuation research project	L	A survey of Australian superannuants
As above	M	Results (findings of the above survey)
As above	N	Recommendations for external reports of superannuation funds
As above	O	Conclusion and recommendations for changes
Other superannuation publications by the author of this submission	P	

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Tentative Paradigms of Superannuation

(The Struggle for Pension Fund Paradigm Dominance and less Compromise in their Reporting)

Dan Scheiwe

Compromise in pension fund accounting

There is significant is disagreement regarding pension fund accounting in Australia, UK and USA. This may also exist in other countries, but those countries are outside the scope of this paper. Evidence of this disagreement includes the following:

- Australia
  - The most relevant accounting standard (AAS 25) is highly controversial and does not have statutory backing (Klumpes, Scheiwe, Robles and Tower, Andersen and Sharpe).
- UK
  - The most relevant accounting pronouncement (SORP 1) is not an accounting standard, rather it is only a statement of recommended practice, and does not have statutory backing.
- USA
  - The most relevant accounting standard (FAS 35) involved a dissenting opinion being expressed by 3 of the 7 members of the FASB that passed that standard. In addition, that standard deals only with one type of pension fund, and no pronouncement has been issued regarding the alternative type of pension fund.

Intuitively there are two major questions that should be answered for accountants, but to date have not been answered:

- In what regards are those accounting pronouncements controversial
- Why are those accounting pronouncements controversial

In what regards are those accounting pronouncements controversial

This is outside the scope of this Senate submission.

Why are those accounting pronouncements controversial

There are disagreements within the accounting profession regarding pension fund accounting, and also there is disagreement between the accounting profession and other parties regarding pension fund accounting. For example,

- Klumpes chronicled the dispute between the accounting profession and both the actuarial profession and the superannuation industry regarding pension fund financial reports
- Klumpes showed that there were low levels of compliance with AAS 25 in Australia and with SORP 1 in the UK
- Scheiwe showed that there were major inconsistencies between AAS 25 and (a) Australian GAAP and (b) the Australian accounting conceptual framework

- Scheiwe also showed that the compatibility of AAS 25 with its overseas and international counterparts had been overstated, possibly for a political advantage in trying to gain acceptance of that standard by the accountancy profession and others.
- Robles and Tower showed that due process had not been followed in the development of AAS 25
- Both AAS 25 and SORP 1 have been revised (the latter more than once)

As a result of some of the above disagreements over pension fund accounting, the present pension fund accounting pronouncements are an unhappy compromise, suggesting that more work is needed to find a solution that is more acceptable to all parties. Just as life constantly involves compromises, so accounting involves many compromises (eg. the compromise between relevance and reliability, to mention only one). Thus a key question is how much compromise is necessary? The answer is reflected in the notion of general acceptance of accounting principles, rules and standards. Therefore, provided that accounting reports reasonably satisfy the reporting needs/objectives of the major users, then an acceptable compromise/balance will prevail, at least for a while. However, given the dynamic nature of societies, what is acceptable one day, may not be acceptable the next.(ie. compromises must change as the competing forces in society change). In more formal parlance, as the political economy changes, so what is acceptable will change.

In the world of pensions, there are different groups which have different views about the nature and purpose of pension funds. These may be thought of as paradigms. As the relative power of those groups change, so the dominance of paradigms will change (refer Lakatos). The conflict over pension fund accounting is a reflection of the change in the dominance of the paradigms. In broad terms, the dominant pension funds paradigm is changing from the employer paradigm to the employee paradigm, though there is competition from a government paradigm and an independent private sector paradigm (which I shall refer to as the assurance paradigm). In Australia (and elsewhere) there is a major problem in that the pension regulatory system (accounting and law) is out of step with the burgeoning conceptual reality (ie. the emerging pension paradigm). Thus it is most important to identify the competing paradigms as this should explain the legal and accounting anomalies and thus be a basis for finding a new compromise in pension fund regulation.

Tentative pension fund paradigms

The following are tentatively postulated as pension fund paradigms:

(1)

Paradigm	the employer paradigm.
Nature of pensions	Pensions are gratuities benevolently bestowed upon employees by employers. Pensions are not promised and so are not terms of employment.
Have there been changes within this paradigm	Yes. One change has been from only some employers providing for employee pensions, to

	virtually all employers so providing. The second change has been from only senior staff (if any) receiving pensions, to virtually all staff being eligible for same. (Also see the employee paradigm on this point)
Who should control the funds	Employers
Why should that party have control?	So that they can selectively reward those employees most useful to them, thus encouraging other employees to serve well
What type of fund is appropriate	Defined benefit – because the employer can transfer wealth from the rank-and-file employees (who were not originally provided for) to those who have served their master "best" – the senior staff. This wealth transfer is accomplished by tying pension benefits to salaries which are controlled by the employer. The rank and file are impressed by the egalitarian behaviour of their employer who contributes the same percentage of salary to the relevant pension fund for all categories of employees (not always the case). The underlying cross subsidisation in defined benefit plans is not understood by the rank and file employees (and their union representatives) because of lower level of financial "sophistication" than senior staff and their employer. Thus for a time they live in blissful ignorance. Other devices (fund rules) are also employed to further promote the same ends. (Compare employee paradigm on this point.)
What is the scope of the fund	Scope limited to the extent necessary for the employer to retain control. Thus corporate funds (as distinct from industry wide fund initially preferred. (Compare employee paradigm on this point)
Who manages the fund	The employer, who also sees relevant costs as part of the cost of employing staff.
Focus of financial reporting	The size and effect of the fund's surplus or deficit on the employer.
Other accounting issues	Of course there is no need for audits and financial reports to employees
Investment issues	The fund may provide a useful source of finance for the employer. Of course there is no need for independent investment managers, fund administrators, or custodians.
Ownership of fund assets	These belong to the employer because payment of pensions is completely voluntary.

(2)

Paradigm	the assurance paradigm.
Nature of pensions	Pension are life assurance policies.
Ownership of the fund	The assurance company
Have there been changes within this paradigm	Yes. Assurance companies were useful providers of death and/or disability cover to limit employer risk exposure as workforces increased in size, but later they became players in the market in their own right by operating public offer funds, especially for self employed persons and for small employers who did not want the task (and cost) of administering the fund. In addition, other financial institutions (especially banks) wanted an involvement in the assurance companies' domain.
Who should control the funds	Certainly not the employees. It had to be the assurance company since often they were the only once who could spread the risk widely enough.
Why should that party have control?	Because, if employees had control they would want their contributions plus a proportionate share of the profit. This is not the way assurance works. Assurance involves cross subsidisation ie collectively the members bear the cost of losses suffered by individual members (eg death or disability). Consequently those who live shortest or longest do best out of the fund.
What type of fund is appropriate	Pension (as distinct from lump sum). Should it be defined benefit or defined contribution? It probably doesn't matter except that a defined benefit fund adds complications and in the long term may add the risk that rank and file employees will one day realise that such a fund is not in their best interests.
What is the scope of the fund	The bigger the better since it facilitates spread of risk.
Who manages the fund	Obviously the assurance company since they bear the risk.
Focus of financial reporting	The financial stability of the fund and the assurance company since this implies that pensions will be paid in the long term.
Other accounting issues	Of course there is no need for audits and financial reports to employees, just as there are no audit reports issued to holders of any other assurance policy.
Investment issues	The assurance company pools assurance risk and of contribution monies from numerous employer

	sponsored funds and from self employed policy holders. This is beneficial to all parties involved, but especially the assurance company. Considerable vertical integration is also possible eg. Fund administration, investment management, custodianship

(3) Government (This paradigm has two aspects: (a) government as employer and (b)government as welfare provider)

Paradigm	the government paradigm.
Nature of pensions	A retirement income that doesn't have to be paid by government if provided for by employers or employees.
Ownership of the fund	(a) Most government pension funds were unfunded defined benefit funds. Thus they were more in the nature of liabilities than assets which were "owned". (b) Contemporary governments have moved towards defined contribution funds, but again do not want to own the funds because this implies all sorts of responsibility for it. These can be minimised if funds are operated by the private sector. That approach is also consistent with governments trying to escape financial responsibility for an ageing population.
Have there been changes within this paradigm	Yes. (a) Having been made to face the level of unfunded liability for public sector pensions, government have moved towards funded DCPs. (b)Governments are concerned about being able to provide aged pensions to an ageing population and so are forcing people to provide for their own retirement, but are being careful not to call this financial provision a tax, but rather an impost on employers (not employees).
Who should control the funds	Certainly not the employees. They're too stupid, as are their union representatives. However, the employer is not to be trusted either. In addition, the government does not want responsibility. Thus control has been vested jointly in employers and employees. Putting union representatives on trustees boards also provided a financial sweetener

	for unions to accept the Clayton's retirement income tax.
Why should that party have control?	For the reasons above.
What type of fund is appropriate	(a) DBPs are still attractive since they enable selective rewarding, but given the shock of facing the level of unfunded liability for public sector pensions, governments sought to minimise that by changing to DCPs. The ageing population also meant that future generations may not be able to afford the intergenerational cross subsidisation. DBPs would still (b) Defined contributions funds that pay pensions (as distinct from lump sums). This is because (a) DCPs usually involve less cross subsidisation between members and so arguably are fairer, and (b) the cost of benefits for those who live shortest or longest. Is borne by the group, not the government.
What is the scope of the fund	(a) Public sector funds were industry wide (within the constitutional limit of the particular government eg. State or federal level), but with increased corporatisation, increasingly funds are likely to be corporate funds, though the trend is for these to be industry wide anyway. (b)Universal should be preferred since this will minimise government expenditure on aged pensions.
Who manages the fund	A board of trustees consisting of employer appointees and employee "representatives" (often appointed by the relevant union)
Focus of financial reporting	Ideally the funds should be accountable to the members but there are several problems: (a) if funds are not run as the assurance lobby wants, they may refuse to remain involved and force the government to be responsible for the funds. Thus the government may be obliged to tolerate a certain level of exploitation of members by the assurance lobby. (b) Members are too stupid to operate the funds themselves and/or may not operate them as government wants them to be operated (c) Unions have the same problem, and allowing unions to run them would be giving too much power away for conservative governments and their supporters.
Other accounting issues	(a) With the move to DCPs government will (as

	employer) have less interest in the reports of pension funds (b) If the members are too stupid to monitor the management of their own funds, and government doesn't want to get too heavily involved, who do the funds report to, and therefore what should they report?
Investment issues	(a) As employer, the government's with investment performance is no longer as important since they are moving to accumulation plans. (b)As social welfare provider, government should be concerned about investment performance and security of benefits so as to minimise the amount it will have to pay to an ageing population as aged pensions (as supplements to private retirement benefits). To avoid double jeopardy, funds should not be able to have major investments in the employer sponsor. The volume of money controlled by superannuation funds will continue to grow rapidly and therefore will continue to grow in importance and influence.
Regulation	Government had long provided tax incentives for people to contribute to pension funds but abuses of the relevant tax provisions, some laws were changed to ensure that tax concessions were only provided for bona fide pension plans. Relevant cases also focused attention on the relevant constitutional validity, thus causing changes in pensions law and related tax law. Also, since the government was effectively forcing employees into pension funds, they had a moral obligation to provide some/improved statutory protection for the relevant "investments".

(4) the employee paradigm

Paradigm	the employee paradigm.
Nature of pensions	Pensions are deferred income of the employee
Ownership of the fund	The employees
Have there been changes within this paradigm	Yes. Employer contributions to pensions funds became part of the remuneration package offered by employer to attract appropriate staff, and so

	retirement benefits became enforceable rights. Thus, as pension funds moved out of the private domain of the employer, employees became more aware of the deceitful practices of employers as regards pension funds. Legislative changes occurred to placate employees and their representatives but it is highly questionable whether that legislation ahs been effective (eg Scheiwe, 1999).
Who should control the funds	The employees were seen not financially literate, and so too vulnerable to be put in charge of their own pension funds, especially since they are so important to government policy in a world of ageing populations. The next best alternative/hope was to have unions involved. A legislative compromise was passed.
Why should that party have control?	Effectively employees are the owners of the fund.
What type of fund is appropriate	DCPs (because arguably they are fairer) Lump sum funds – since each relevant person can invest as s/he sees fit when the benefit is paid and it is nearer to the principle of user pays ie. your retirement benefit depends of what you have put aside (and what that investment has earned) not on cross subsidisation from a pool . Similarly, since the employee owns the pension fund investment, s/he should be able to bequeath any residual rather than forfeiting it to a pension pool. This is consistent with the notion of private ownership of the contributions (deferred income).
What is the scope of the fund	National occupational funds have the advantage of no loss of benefits through changing employment (within the same industry). Private funds have the advantage of giving the individual control over investments of the fund (for better or for worse). The solution appears to be choice of funds since this will optimise performance and benefits.
Who manages the fund	No matter what type of fund is chosen, as far as possible, and to the extent they desire, members must have the same rights as other investors. Those who want maximum control are likely to opt for (small) private funds, while those not wanting that level of control (for whatever reason), may willing surrender control to another party eg. In a large fund where there is clear separation of

	ownership and management.
Focus of financial reporting	In summary, whether all 3 benefits are being optimised.
Other accounting issues	Reports are prepared for members Reports must be understandable to members Reports must convey information which allows members to decide whether all of their benefits are being optimised ie. the same issues raised by accounting conceptual frameworks including allocation of resources
Investment issues	Not everyone will be better off under a regime that gives freedom of choice since they will be subject to the vicissitudes of the market and their own folly. However, the previous systems have not worked optimally either. The advantage of this paradigm is that it is consistent with democracy and market based economies which we claim to embrace. While it may not please governments at the macro level, this paradigm should also allow individuals to optimise their wealth by more timely and appropriate allocations eg. Deferring superannuation contributions to pay of a housing mortgage quicker, and later channelling a higher level of contributions into their pension fund, thus maximising longer term wealth.

c:\work\papers\towrite\model

Why Australia's pension system is not a good international model.

By

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Abstract

In this paper, the author challenges claims attributed to two UK pensions experts, that Australia's pension system is worthy of praise and emulation. The author describes the mismatch between the pensions system introduced by the Australian government and the associated system for regulating it and protecting members' interests. He says that as a result of this mismatch, there is virtually no pressure to ensure that members derive optimum benefits from their pension funds, and accordingly he predicts that the present system will fail to adequately provide for most members' retirement, with the result that the national government may still be called upon to significantly fund the retirement incomes of an ageing population.

Why Australia's pension system is not a good international model.

1.0 Introduction

Some overseas commentators such as Goode and Ellison (Hely, 1990) have praised Australia's pension system. Unfortunately such comments are misleading. Australia's pension system may be better than those in some other countries (depending on the perspective one takes) but there are compelling arguments that Australia's pension system is very seriously deficient. Given the ageing population in many western countries, the notion of a system which will enable relevant democratically elected governments to overcome the untenable burden of funding aged pensions from a declining proportion of the population, without explicitly raising taxes to the level necessary, must be welcome news. That is what Australia claims to be doing. It is unfortunate that it is not true. This paper explains why.

Instead of using the term "superannuation fund" which is the Australian vernacular, this paper uses the term "pension scheme" because (a) this paper is addressed to an international audience, and (b) the latter term is used in the United States of America and in the United Kingdom, rather than the former term. The term "superannuation fund" is used in Australia because (a) many Australians take their superannuation benefits in the form of a lump sum rather than as a pension. The Australian government has provided various tax incentives to dissuade retirees from taking lump sums, but has stopped short of legislating to stop them. (b) the term "pension" was usually used in reference to the raft of non-contributory payments by the government to aged persons, war veterans, invalids, etc., and (c) the term "annuity" was used instead on "pension" to refer to regular payments from a contributory pension scheme. More recently, it has become politically correct in Australia to refer to most social security payments, including unemployment payments, as "pensions". This paper is not about those types of pensions. It is about contributory arrangements for self provision of retirement income.

2.0 Outline of Australia's pension system

The Senate Select Committee on Superannuation (SSCS, 1992 pp.10, 11) reported the following:

1974 32% of Australian workers were covered by superannuation

1979 43% of Australian workers were covered

1983 47% (approx.) of full time workers were covered, and 9% (approx.) of part time workers were covered.

1988 the above percentages began increasing significantly

1990 the rate of increase significantly escalated

Later the Insurance and Superannuation Commission (ISC, 1996) reported the following coverage.

1995 81% of workers covered - 95% coverage for full time employees, and 72% for part time employees.

The increase in coverage is a statistic that the Australian government is proud of and it suggests that the relevant policy has been a very effective response to the problem of funding old age pensions for an ageing population. The next section of this paper describes why the reality is different.

There is no statutory requirement for self employed Australians to contribute to a pension scheme. However, with some exceptions, Australian employees are members of pension schemes either by virtue of employer contributions under the Superannuation Guarantee Charge Act (SGCA) or because of the industrial award or agreement under which they are employed.

At present the employer contribution under SGCA is 7% of salary/wages but this will increase to the current maximum of 9% by 2002/3. Under SGCA and associated legislation employers are required to contribute the relevant percentage of salary/wages to an employee pension scheme or alternatively be levied a superannuation guarantee charge. The incentive to "voluntarily" contribute is that voluntary contributions are tax deductible to the employer, whereas the SGC is not. In addition, employers required to pay the SGC are also charged administration fees and interest on arrears. This part of Australia's pension arrangements is administered by the Australian Taxation Office (ATO). After collection of any SGC, the ATO then arranges to transfer the relevant

amount to individual employees' pension schemes, or in the case of small amounts, it may be temporarily held in the ATO's Superannuation Holding Accounts Reserve (SHAR).

Very low income earners can opt to receive the relevant cash rather than have their employer contribute under SG arrangements. Similarly employers do not have to make SG contributions for (part time) staff: earning less than $450 per month; staff under 18 years of age and working less than 30 hours per week; staff over 70 years of age.

Even though the relevant federal government chose not to call it a tax, SG contributions could be regarded as a special purpose tax on employees ie. one similar to the USA's social security tax. Similarly they did not call it an impost on employees, even though the Labor treasurer at the time said (sic) that future increases in employees' wages could take into account employers' contributions to employee pension schemes (Dawkins, 1992).

The reasons for not calling it a tax include: at the time of introducing the new scheme, it was politically more palatable to lower income earners, unions and a Labor government, to call it a charge on employers rather than a tax on employees; income taxes cannot discriminate and so imposing a tax on employees without imposing a comparable tax on self employed persons would be unconstitutional. This approach was also used again when later the coalition federal government introduced the superannuation "surcharge" - a tax on superannuation contributions of high income earners. However, the federal Labor government that introduced compulsory contributions to pension schemes did not want to defer all of the tax on the income that employees forfeited to pension schemes, and so they began taxing contributions to superannuation funds made by employers (on behalf of employees). The other income of pension schemes was also taxed at 15%. The contributions tax was set at 15%. A further 15% payable when retirement benefits were eventually paid. The latter 15% did not apply to the employee contributed component of pensions. Subsequently the tax rules were again changed so that no tax was payable on small pensions and small lump sums, and higher tax was payable on "excess" components of larger retirement payments.

If employers contribute to employee pension schemes under an award or industrial agreement and that contribution at least equals the relevant SG percentage, then they are deemed to have satisfied their SG obligations.

Self employed persons can voluntarily contribute to a pension scheme and can claim a tax deduction of up to $3000 for same. (Employees cannot claim a tax deduction for their contributions). A small tax concession is also available for any person contributing to a pension scheme for a spouse with a very low income, and a very small tax concession is available for pension contributions by very low income earners.

Australian pension schemes can be classified in various ways. For example the ISC (now called the Australian Prudential Regulation Authority) is the join regulator of the Australian pension industry, along with the Australian Securities and Investments Commission. Excluded schemes are regulated by the ATO. APRA classifies schemes as (ISC Annual Report 1995/96, p.74):

corporate	(ie. schemes operated by employers solely for their employees)
industry	(ie. those which nationally cover employees in a particular industry. These are likely to be dominated by relevant unions)
public sector	(ie. those operated by various levels of government)
retail	(ie. those which are operated by insurance companies and other profit oriented entities, and which basically invite any member of the public to join them eg. self employed persons, and small employers. These are also know as public offer funds.)
excluded	(ie. these have less than 5 members and are allowed certain regulatory concessions.)

(NB. the bracketed descriptions above are those of the authors, not descriptions provided by the ISC.)

In addition, each of the above categories of pension scheme can be either defined benefit schemes or defined contribution schemes. A small proportion of funds are hybrid schemes - ie. partly defined benefit and partly defined contribution. Defined benefit schemes are schemes under which the dollar amount of members' benefits are

determined according to a formula set out in the constitution of the scheme. These are usually based on highest average salary of individual members, or on their final average salary for the relevant three year period. Defined contribution schemes (also known as accumulation schemes) are those under which the dollar amount of members' benefits are determined by contributions plus a share of net income of the scheme after taking into account transfers to or from any internal reserves. This type of scheme is favoured by the unions because they are fairer to the majority of members. Not surprisingly industry, retail and excluded schemes are usually defined contribution schemes, with public sector schemes having the highest proportion of defined benefit schemes (about 75%, though that is decreasing).

At 30.6.1996, Australia had 140,000 pension entities consisting of 137,000 pension schemes (approximately 96% of which are excluded funds), 2,700 approved deposit funds, and 295 pooled superannuation trusts. The largest 1100 schemes held 85% of Australia's superannuation assets, and 77% of schemes each held less than $250,000 in assets. In 1995/96 the number of excluded funds grew by 25% (ISC annual report, 1996).

In 1986 as part of the accord between the Australian government and the union movement, instead of the federal Industrial Relations Commission granting workers a 3% wages increase, it was agreed that employers would pay 3% into pension schemes for employees under relevant industrial awards. This was an early government move towards implementing a retirement incomes policy to cope with an ageing population. Since many Australians did not work under an industrial award, the arrangement did not give contributory pension coverage to many employees. To overcome this deficiency in their retirement incomes policy the Australian government introduced the Superannuation Guarantee Charge Act and associated legislation in 1992.

Since it had effectively embarked upon a regime of forced employer/employee contributions to pension schemes in 1986, the Australian government was obliged to either provide a government operated contributory pension scheme or alternatively provide statutory regulation of private sector contributory pension schemes. The government chose the latter and accordingly introduced the Occupational

Superannuation Standards Act in 1987. Because of deficiencies in this legislation, it was replaced by the (current) Superannuation Industry Supervision Act (SIS) in 1993. In fact Australia's contributory pension arrangements are regulated by several acts, but SIS is the major one. Some of the other legislation is briefly referred to later in this paper.

3.0 Why Australia's pension system is not a good one

This section of the paper will describe why Australia's pension system is not a good system (a) from the government's perspective and (b) from a scheme members' perspective

3.1 From the government perspective

From the above it is clear that a major component of the Australian government's retirement incomes policy is compulsory contributions to pension schemes by Australian employees (directly or indirectly). These contributions are compulsory under either an industrial award (or similar), or under the SGCA.

One objective of that retirement incomes policy is for Australians to provide their own retirement income, rather than being dependant on a government old age pension. While the government proudly points to the high proportion of employees covered by a contributory pension scheme, the reality is that :

(a) it will take some 40 years for the policy to be fully operational because the present dollar level of coverage per person (as distinct from % of workers with some coverage) is grossly inadequate for most of the new entrants to contributory pension schemes.

(b) even when the present government policy reaches maturity after 40 years, the level of compulsory contributions (maximum of 9% in 2001 and thereafter) will not provide an adequate level of retirement income. Fitzgerald (1993) suggests that the level of contributions should be about 18% of income. To counter this deficiency, the Labor federal government had proposed matching (on a dollar for dollar basis) the pension scheme contributions of/for low income earners. However, when they lost the federal election in 1995, the new coalition government scrapped that aspect of the federal retirement incomes policy.

(c) the system of compulsory contributions does not cover self employed persons (unless they are "employees" of their own company) and does not cover very low income earners and those in receipt of social security pensions (the latter being a high proportion of the Australian population).

(d) as described below, the system implemented to regulate Australia's compulsory contributory pension scheme does nothing to ensure optimum returns and hence optimum benefits will be derived by members.

In addition to the above, the government is on the horns of a dilemma. The more it forces Australian workers to contribute to pension schemes, the less disposable income those workers have to spend and stimulate/maintain the Australian economy. Even worse, the burgeoning funds in pension schemes are inflating share prices and eventually there will have to be a major stock market "correction" and huge amounts will be wiped off accrued pension benefits.

3.2 From a member perspective

From the member perspective, Australia's pension system is grossly deficient and as a consequence sub optimal benefits will be derived, thus ensuring continued dependence on government funded social security. The reality of this is reflected in the pressure from various sources, for sustained high level of immigration to fund the shortfall. Unfortunately, at best, this is simply deferring the problem not solving it.

The root cause of the sub-optimal returns being derived by members of Australia's pension schemes is the mismatch between system implemented (which some referred to as privatisation of Australia's pension system) and the relevant regulatory arrangements. The present contributory pensions system has been described by the relevant regulator as "market oriented (Roberts et al, 1994) but the relevant legislation ensures that the system cannot be market oriented, but rather that it is undemocratic, protects under performing and/or dishonest trustees, fails to protect members, and does not foster optimal performance.

Australia's pension system is not market oriented because the fundamental attribute of a market economy is perfect competition. Australia's pension system does not even

have imperfect competition let alone perfect competition. This is because perfect competition assumes informed consumers and freedom of entry and exit from relevant markets. At present, in the Australian pension "market", employees do not have a choice of whether they are members of a pension scheme and certainly do not have a choice of scheme to be in. The present federal government has tried to bring in choice of pension scheme legislation but as yet that has not occurred. The proposed legislation requires employers to give employees limited choice of scheme (from at least four types of scheme) or unlimited choice. The relevant decision rests with employers, not with employees. No choice and limited choice seem rather strange since many employers pay their staff by electronic funds transfer to individual bank accounts. The argument for doing this included the security costs of paying in cash or by cheque. Therefore, if it is more convenient for employers to pay staff electronically via individual bank accounts, it should also be convenient to electronically transfer pension scheme contributions electronically to any designated scheme's bank account. This leaves one to speculate that it is the pension industry which is reluctant to see this "innovation". At present pension scheme contributions go to the scheme agreed to by the employer and relevant union, even though the majority of employees may not be union members. Under such a cosy arrangement, there is little pressure for optimal performance by the relevant scheme. If members were free to change schemes then this would put pressure on trustees to provide optimal service and returns.

Over 94% of Australian pension schemes are trusts (Quinlivan, 1994). In virtually all of those cases, the trustees are not elected or not directly elected by the members. Thus the typical scenario for an Australian pension scheme is that members have no choice about being a member and do not elect the trustees. That scarcely sounds democratic. The relevant legislation requires that half of the trustees must be employee representatives and half must be employer representatives. The requirement to have half of the trustees represent employers has been strongly criticised (eg. ALRC, 1992; Scheiwe, 1997). In addition, there is no requirement for election of trustees because that legislation only makes reference to "appointment" of trustees, not "election" of same. Having half of the trustees as member representatives was heralded as a prudential safeguard because previously there was no requirement for any employee representatives. Unfortunately the situation may in reality have changed very little if the

employer representatives are financially aware but the employee representatives are not financially aware. There are no knowledge pre-requisites for appointment as a pension scheme trustee and so different levels of relevant knowledge among trustees is a real possibility, especially where many trustees are appointed simply because they are union officials rather than because they have particular financial skills. Such appointments may provide unqualified people with significant direct remuneration and other perquisites, but leave the members inadequately represented and protected.

Except in excluded schemes, trustees cannot be directed by the members and generally are not liable for their financial mismanagement. Pension schemes are not required to hold annual general meetings as companies (for example) are required to do, and so superannuants have less rights and protection than shareholders. Company annual general meetings are important because members receive and can debate the accounts, receive the audit report and question and appoint the auditor, elect or vote out directors, set the directors' remuneration, etc. Members of Australian pension schemes have none of those rights and none of the relevant protection. It could be argued that most members are not financially literate enough to benefit from an AGM (eg. Quinlivan, 1993). That may be true at present, partly because members have no choice about the fund they are in and are denied the other normal rights of an investor. Hence they see little point in taking an interest. If there were choice then members would be more interested and could learn by attending annual general meetings and at least listening. This would generate substantially more ongoing discussion among members about their pension schemes. The difference between the rights of Australian shareholders and the rights of Australian pension fund members is quite astounding and simply serves to protect under performing schemes and under performing trustees.

Despite more than a decade of legislative innovation and reform, many Australian superannuants can still be cheated by their own pension scheme eg. by trustees misusing their power to withhold (ie. put in reserves) an unspecified amount of defined contribution schemes' income (provided this is permitted by the relevant trust deeds). By various means, the membership of such funds can be run down until all of the reserves are paid to the intended few remaining members who derive substantially

better reserves than other former members of the same scheme. A similar scam is possible in funded defined benefit schemes, especially in times of wages restraint which Australia has experienced for over a decade. This scam involves cross subsidisation between scheme members (Scheiwe, 1996). This occurs because benefits in a defined benefit scheme are based on either final average salary or highest average salary. Senior management are most likely to be the greatest beneficiary of the cross subsidisation because they are the most likely to gain significant salary increases while restricting increases in wages and salaries of the majority of members of these employer sponsored funds (Scheiwe, 1997).

The annual reports of Australia's pension industry regulator show the extremely small proportion of pension schemes that it was able to review in light of the limited resources at its disposal. Even if it did find mismanagement of funds, it could not tell members, unless it launched a prosecution, because of the secrecy provisions in the relevant legislation (Scheiwe, 1999). The relevant SIS provision was revoked in mid 1998 but a similar provision still exists in the superannuation guarantee legislation. Thus members are not in a position to monitor the management of their own pension schemes (Scheiwe, 1996b)and the relevant regulator is knobbled as well.

There was established a Superannuation (Resolution of) Complaints Tribunal under a relevant statute. However, that legislation also severely restricted members' right to complain to that independent arbiter. For example, the tribunal could not hear complaints about the format of a pension scheme, even if it was an unfair one like those described above (Scheiwe, 1999b). Its capacity was even further reduced in 1998 by a court decision which ruled that the relevant legislation was in part, unconstitutional.

The accounting standard under which most large superannuation funds prepare their financial reports is so controversial that it has not been given statutory backing (Klumpes, 1994). That standard has been described as an accounting enigma (Scheiwe, 1993), because it rejects several other Australian accounting standards, is inconsistent with generally accepted accounting principles, and with the Australian accounting conceptual framework. The outcome of this situation is that the full raft of relevant

accounting standards is not applied to pension schemes, but are, for example, applied to Australian companies. For example, there is no consolidation of the accounts of the pension scheme and its associated companies, and there is no statutory requirement to apply the related parties accounting standard (Scheiwe, 1999c). Thus many pension fund members don't know the total remuneration paid to trustees from the various entities associated with their pension fund. Also, the level of assurance provided by the audit of Australian pension schemes is lower than that provided for companies. This is because the audit opinion states that the financial statements "present fairly" (with simply means they comply with applicable accounting standards, no matter how few there are). In contrast the audit opinion for companies states that the financial statements give a "true and fair view ...." (which means that they are not misleading) (Scheiwe, 1999d).

While the relevant legislation requires trustees to formulate and give effect to an investment plan, that legislation is virtually unenforceable and as scheme failures show, it really provides members with no protection (Scheiwe, 1999). Because of the wording of that legislation there is no requirement for trustees to optimise investment returns, with the result that many trustees set investment goals very low, and applaud their own performance in various ways, when those goals are achieved. The result is that members ultimately derive retirement benefits far less than those that they should receive.

Unfortunately many pension scheme members seem to assume that their schemes are being well managed in their best interests and that their golden egg will be there when they retire. The relevant legislation encourages such a false sense of security because it requires the reporting of investment return. That return does not include indirect investment costs, may include unrealised gains in market value of assets, and ignores cross subsidisation in defined benefit schemes and reserving in defined contribution schemes. The result is that the return members actually derive may be far less than the reported investment return.

Clearly Australia's pension system is very seriously flawed and could not be considered as a model by any other country.

4.0 Why has this happened?

One can only speculate as to how this unsatisfactory situation came about.

First, the blind faith attitude to pensions by many Australians means that politicians tend not to give it a high priority. In contrast, the superannuation industry is a powerful and well organised lobby group, because they have such a vested interest in avoiding real reform of the industry eg. by making it truly market oriented.

Second, pensions involve fairly complex law and basically only those who work in the industry receive relevant education. Accordingly legislators rely on the latter for advice in formulating policy and introducing relevant law. Hence the law has been written to suit those who it is intended to regulate, that is, there has been regulatory capture.

Similarly, equal employee representation on pension scheme trustee boards became jobs for the boys (ie. union officials) so that the federal government of the day was able to get its legislation introduced without massive industrial disputes. The outcome is that many employees are still not represented on relevant boards by people with appropriate expertise or diligence. Thus many pension scheme members are deriving sub-optimal returns and the government will not achieve optimal relief from funding aged pensions.

Finally, it appears that the government may have been as much concerned about using pensions legislation to establish an Australian pool of investment funds (to alleviate balance of payments problems) as it was with retirement incomes. This may partly explain why it is so slow to reform the present pension system.

5.0 Conclusion

The conclusion one must reach from the above is that it is necessary for there to be very substantial reform in the Australian pension industry if it is to be fair, perform optimally, and achieve the government's objectives of its retirement incomes policy. This means years of upheaval are still to occur. Accordingly. Australia's pension system should not be used as a model by any other country.

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Superannuants needn't be treated worse than shareholders.

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Superannuants needn't be treated worse than shareholders.

Abstract

This paper selectively compares the rights and financial protection of superannuants with those of shareholders. It shows that financially, many superannuants are in a far more vulnerable position than shareholders. To show that this situation does not have to prevail, the paper then describes one small corporate fund which treats its members more like shareholders than traditional superannuants, thus providing greater rights and protection to its members.

Superannuants needn't be treated worse than shareholders.

Introduction

This paper compares the rights and financial protection of superannuants with those of shareholders. In this paper, the term "superannuants" is being used to mean a member of a superannuation fund rather than a person in receipt of superannuation benefits. The comparison of shareholders and superannuants in this paper is not an exhaustive one but is sufficient to show that a great many superannuants are in a far more vulnerable position than shareholders. To show that this situation does not have to prevail, the paper then describes one corporate fund which treats it members more like shareholders than traditional superannuants, thus providing greater rights and protection for those members.

Protection of superannuants does not simply mean safeguarding against fraud, it also means safeguarding against sub-optimal returns which many superannuants currently are being forced to accept or are accepting as a result of ignorance and apathy. Superannuants are deriving sub-optimal returns on their superannuation because of the way that Australia's superannuation system is being run and regulated. (Ambrovich, 1994 p.8; Scheiwe, 1996a, b, 1997, a, b).

The performance of the Australian superannuation industry has major implications for the retirement incomes of many individuals, for the federal government's retirement incomes policy, and for the Australian economy in general. For example, as at March 1999, the total assets of Australian superannuation funds amounted to $387,152 m. and were allocated as follows:

	$m	%
Cash & deposits	26454	7
Loans & placements	17480	5
Interest bearing securities	90497	23
Equities & units in trusts	154966	40
Land & buildings	20723	5
Other	12495	3
Overseas	64537	17
Total	387152	100

Source: APRA web page.

The significance of the superannuation industry is also highlighted by comparing its assets to the market capitalisation of companies listed on the Australian share market. The latter amounted to $489 billion as at 30.6.1998 (ASX Annual report , 1997/8). Thus the superannuation industry is approximately 79% the size of the corporate sector but grew by $34billion plus fund income in 1997/98 (APRA web page). Therefore it can be expected that Australia's superannuation assets will be larger than Australia's listed companies quite soon.

The distribution of superannuation funds, members and assets is as follows:

	Members " 000	Members %	Funds #	Funds %	Assets $' billion	Assets %
Corporate	1341	7	3463	2	68	18
Industry	5910	30	101	0	28	7
Retail	9003	46	249	0	107	28
Excluded	358	2	182589	98	50	13
Total private sector	**16612**	**85**	**186402**	**100**	**253**	**65**
Public sector	2877	15	41	0	85	22
Annuities, life office reserves, etc	na	na	na	na	49	13
Total	**19489**	**100**	**186443**	**100**	**387**	**100**

Source: APRA web page. March 1999

Despite the above size and importance of Australia's superannuation industry there are conflicting reports about security of monies deposited in superannuation and other aspects of the industry. For example, the Senate Select Committee on Superannuation (1992) stated:

> *The Committee heard evidence which has led it to conclude that, whilst there has been a small number of superannuation fund failures, there does not appear to be widespread malpractice in the industry. However, the Committee is conscious that increases in superannuation savings will inevitably attract operators who will seek to use superannuation monies for their own use. The Committee was strongly of the view that appropriate safeguards need to be put in place now to minimise the risk of fraud, misappropriation and bad management practices.*

On the other hand, there are many expressions of concern about was has happened in the industry rather than what might happen. The following are examples:

Source	Concern
Gray and Dorkins, 1996	"In administrative appeals Tribunal Case W4/447, the primary assets of a fund

	consisted of a private company associated with the employer, and units in the employers' family trust. The investments underlying the shares and units were a golf club membership (carrying playing rights), a seaside house and an interest in a Swiss chalet."
Renton, 1991	"Superannuation fund failures have been rare in this country"
MacKenzie, 1993	High levels of insolvency in superannuation funds
Kavanagh, 1995	"More than 30,000 Australians have had their superannuation funds frozen during the past months as a result of an unprecedented spate of super fund closures and trustee sackings." Quoting the Institute of Chartered Accountants in Australia superannuation spokesman, "...more funds could close"
Australian Society of CPAs, 1991	Superannuation is complex and inequitable Regulations are confusing
Allen, 1992; Klumpes, 1993	Prudential controls are inadequate
Renton ,1991	"Traditionally superannuation funds have not been supervised at all .... This is so despite membership of a scheme being compulsory for many people. ... One problem in this area is that there are no prescribed qualifications for trustees of superannuation schemes."
MacLeay, 1995	The ISC was not "up to the job"
Buchan and Mullen, 1994	"Much of the information provided under AAS 25 could not be understood by the majority of fund members"
Quinlivan, 1992	26% of males surveyed, and 36% of females admitted to being "very confused about superannuation"
Griffith, 1998	"About 24,000 Queenslanders caught up in a failed $30million superannuation fund ...."

Clearly the conflicting views above justify the examination of the security of superannuation savings proposed in this paper.

Why compare superannuants and shareholders?

Private shareholders and superannuants share the following attributes:

- Both are investors (discussed later in this paper)
- There are large numbers of investors of both types, and therefore it is probable that the government with intervene in both markets in the public interest, especially since both industries are so important to the Australian economy, and to each other.
- Both shareholders and superannuants rely on third parties to manage their investments.
- Both companies and superannuation funds are regulated by statue and share a common regulator (in part).

However, as discussed later, there are also major differences between the way the corporate sector and the superannuation sectors operate. It is these differences that are the focus of this paper. The authors are concerned that:

(1) regulations make company directors more accountable to shareholders than superannuation regulations make trustee accountable to superannuants

(2) corporate accountability regulations have been developed over a long period of time and were developed in response to malpractices which caused great financial loss to shareholders since joint stock companies were introduced over 100years ago. Therefore it is reasonable to be concerned that superannuants may suffer similar losses if they have a lower level of protection than shareholders.

Are superannuants investors?

As a discipline, superannuation is still in a development stage. In Australia this is illustrated by the following:

- Legislation: only six years after the introduction of the first statute providing for the regulation of superannuation funds in Australia (Occupational Superannuation Standards Act, 1987) a completely new statute was introduced (Superannuation Industry Supervision Act, 1993). SIS has purported to introduce major fundamental changes in the management of superannuation funds eg. equal

representation of employers and employees on trustee boards, prudential safeguards, operating standards, codified trustee covenants.

- Fundamental concepts: as late as 1992, relevant parties were still debating what constituted a superannuation fund (Australian Law Reform Commission, 1992);
- Accounting and reporting: AAS 25 remains a controversial accounting standard (Scheiwe, 1993; Robles and Tower, 1993) even though there was a prolonged dispute between the accountancy profession ad the alliance (superannuation industry and the actuarial profession) regarding the format and control of superannuation fund accounting and reporting (Klumpes, 1994).

The above facts suggest that there is or has been disagreement regarding basic superannuation issues. Collectively these differences may be referred to as paradigms of superannuation.

Basically there are two superannuation paradigms:

(a) superannuation is part of remuneration earned by employees (Benedict, 1991, ASCPA, 1991, Dawkins, 1992; ASFA 114 p.1.10; Institute of Actuaries, 1992) and so should be controlled by employees who are the residual owners of the fund. This view is supported by the fact that some 94% of superannuation funds are trusts (Quinlivan, 1994), and in trust law, beneficiaries possess an equitable interest in the fund assets (Marx and Baxt , 1981). This paradigm may be referred to as the employee paradigm of superannuation. It has various implications, including preference for accumulation plans, equitable distribution of fund income, and trustee accountability similar to that imposed on company directors. This paradigm is the more contemporary one and is supported by the union movement.

(b) superannuation is part of the employer's system for selectively rewarding employees and so superannuation funds should be controlled by employers. This may be referred to as the employer superannuation paradigm. This is the older paradigm which appears to be the legacy of times when superannuation was something that some employers benevolently bestowed upon selected employees. This paradigm also has various implications, including cross subsidisation between members and/or favouring inequitable distribution of fund income as is done in some DCPs and in

many DBPs. In DCPs employers may control the allocation of superannuation benefits by long vesting schedules. Minimum benefits legislation has not eliminated this practice (Scheiwe, 1999). In DBPs the employer can control the allocation of benefits partly by controlling relevant salaries and wages which in turn may result in cross subsidisation between members of the superannuation plan.

Despite there being two paradigms of superannuation, superannuation contributions are normally deposited into plans in the expectation that members' equitable interest s will grow until they are withdrawn. This is exactly what many investments are: depositing money in anticipation of withdrawing a larger sum (or income stream) in the future. Thus superannuants can be regarded as investors just as shareholders are investors.

This also appears to be the view of the Australian Securities and Investments Commission which stated (Brown, 1998, p.2) ".... Superannuation .... is really a form of investment ....".

Therefore superannuants are investors and it is valid to compare superannuants and shareholders. In particular, this paper compares the rights and financial protection of superannuants with the rights and financial protection of shareholders.

Why Australia's superannuation regulatory system depends so heavily on superannuants' rights

Superannuant protection could be provided by considerable regulation and intervention by government. However, the federal government did not introduce such a regulatory system. Instead, the financial protection of superannuants depends on their rights: to relevant, reliable and timely information; reports by independent auditors; their appointment and removal of relevant governing bodies; to chose and change investments. Shareholders have those rights, and hence financial protection, but, as shown below, superannuants do not have them.

As part of its retirement income policy, the Labor federal government effectively forced most Australian employees to have superannuation (91% superannuation coverage of employees as at March 1999, APRA web page). Both OSSA and SIS reflect the fact that the federal government was not going to be directly involved in the superannuation regime it introduced (eg. by operating a federal government superannuation scheme). Instead the federal government has allowed the private sector to operate most Australian superannuation funds (over 99% of Australia's superannuation funds and 85% of members are in the private sector, APRA web page, March 1999). This approach avoided undermining existing superannuation providers and minimised the federal government cost of implementing its superannuation policy.

SIS has placed heavy reliance on fund trustee compliance, auditor whistle blowing, and member monitoring of their funds. This explains the ISC statement that an informed membership is a central plank in the regulation of Australian superannuation industry and that the relevant regulatory system is "market oriented" (Brown et al, 1994).

Even though APRA undertakes some fund reviews to check on whether the prudential safeguards in the relevant legislation are being followed, the number is so small that APRA concedes that member monitoring is critical to ensuring that funds are properly run.

Unfortunately the relevant legislation does not put superannuation fund members in a position from which they can ensure that their funds are properly run. Hence the Australian system for regulating the superannuation industry is fundamentally and serious flawed:

- on the one hand, superannuants are not provided with information which allows them to decide if their funds are well run, and do not have the power to rectify the situation of they are dissatisfied. Ambrovich (1994) claims that there is a burgeoning of dissatisfaction with superannuation benefits and entitlements.

- On the other hand, superannuants are not given the statutory protection that their vulnerability deserves.

Some argue that this is so because regulatory capture has occurred ie. the industry that is supposed to be regulated, has in fact influenced government in such a way that the rules have been written to suit the industry, not to safeguard members' funds effectively (Taylor and Little, 1993).

There have been many amendments to Australia's superannuation law since 1993, but they have not overcome the fundamental flaws in Australia's superannuation industry. For example, major changes regarding responsibility for different aspects of regulating Australian superannuation were introduced in 1998. Unfortunately these do not appear to have increased superannuant protection provided by relevant regulators. In fact the level of protection for some 97.5% of Australian superannuation funds may have decreased (APRA web page, March 1999). For example, excluded funds (now called self managed funds) became the responsibility of the Australian Taxation Office (ATO). This suggests that the government's concern regarding these funds is loss of tax revenue, not protection of fund members.

While the transfer of responsibility for excluded funds to the ATO and transfer of other responsibilities to ASIC reduced APRA's workload, it has also been given responsibility for the prudential supervision of other types of deposit taking institutions eg. banks, credit unions and friendly societies. This means that now there are three agencies responsible for different aspects of superannuation. How well this division works remains to be seen, but it is a concern that now there is NO ONE agency responsible for overall regulation of superannuation. This concern is heightened because a personal inquiry revealed that all of ASIC's superannuation staff are located in Sydney. In addition, ASIC will not focus on excluded funds because (a) in most cases they are not reporting entities, and (b) they are given certain reporting exemptions anyway.

The above developments suggest that member monitoring of their own funds is more important than ever.

The next section of the paper will show why superannuants are not in a position to ensure that their funds are managed properly. This will be done by comparing superannuants' rights with those of shareholders.

Why superannuants are not in a position to monitor and influence fund performance

While 28.5% of Australians directly own company shares (ASX Annual Report, 1998), superannuation coverage rates quoted earlier in this paper suggest that a higher percentage of Australians directly invest in superannuation (not necessarily voluntarily). Thus one would expect that superannuants would have at least the same level of statutory protection as shareholders. That protection is obtained in three ways:

- obtaining relevant reliable and timely information about their fund
- the ability to influence management
- the ability to chose and change investments.

However, the following comparison reveals that superannuation fund members have considerably less protection than shareholders.

	Shareholder	**Superannuant**
1	Shareholders have the choice of whether to invest in shares or not.	Most employees don't have a choice of whether to be in superannuation or not. If not mandated by an award or industrial agreement, membership is mandated for employees by the Superannuation Guarantee Administration Act 1993.

2	Shareholders choose which companies to invest in.	Most employees have no choice of which fund to be in, though the Howard government was trying to introduce choice legislation. However, that proposal allowed employers to opt for a limited choice model.
3	If dissatisfied with their company's performance, shareholders can sell their shares and invest elsewhere.	Most employees have no option to change funds without changing employment
4	Shareholders automatically receive an annual report, including full audited accounts	Only limited reporting to superannuants is required and only unaudited summary financial information need be provided unless full audited accounts are specifically requested by members.(SIS regulation 2.29(e))
5	Shareholders can convene meetings and attend statutory company annual general meetings at which they can ask questions and hear questions from other shareholders.	Legislation does not require superannuation funds to hold AGMs and does not give superannuants power to convene meetings of members. Superannuants cannot vote out trustees and trustees can appoint third parties to the board (s.108). Superannuants don't enjoy the synergism of AGMs
6	Shareholders appoint their company's auditor in turn who reports to them.	The trustees appoint the auditor who reports to them (SIS s.113). Even if the auditor is dissatisfied with what s/he finds, there is no requirement to report this to APRA unless the trustees do not rectify the problem (SIS s.129). Members are told nothing by auditors.
7	Auditors must explain to ASIC if they	No explanation for auditors to resign

	wish to resign from an engagement.	need be given to APRA or ASIC and confidentiality provisions meant superannuants were not told the outcomes of ISC reviews.
8	Shareholders set directors' remuneration.	Superannuants do not set trustee remuneration and there is no requirement to report that remuneration to members.
9	There are statutory provisions re oppression of minority shareholders.	There is no comparable provisions re. oppression. The superannuation complaints tribunal had very limited powers (Superannuation Resolution of Complaints Act, s.14; Abramovich, 1994) and even these have been ruled unconstitutional (Wilkinson v Clerical Administrative and Related Employees Superannuation Fund Pty. Ltd., 1998).

The comparison above clearly shows that superannuants have far less rights to properly monitor and control their superannuation plans, and hence have far less financial protection than shareholders. However, the superannuation industry argues that the prudential safeguards for superannuation far exceed those for companies and so superannuants are protected. In contrast, for example, the Australian Society of CPAs noted (1991, p.21) that there is a lack of employee control in superannuation funds and that as a result, there is loss of benefits. The ASCPA concluded that employees need more involvement in the management of their superannuation funds.

The next section of the paper will show why the statutory prudential safeguards fail to protect member's investments in their superannuation funds.

Why Australia's prudential safeguards do not provide adequate superannuation protection

Prudential safeguards are simply statutory provisions which seek to ensure that funds are prudently run so as to protect (ie. optimise) superannuant benefits. Even if well drafted, such provisions can not eliminate superannuation risk. However, as explained below, Australia's prudential safeguards do not provide adequate protection for members' funds. Selected important safeguards are discussed to illustrate this.

(1) *Relevant accounting standards should require financial statements that provide information useful to users in making and evaluating decisions on the allocation of scarce resources (Statement of Accounting Concept # 2)*

The prudential safeguards regarding accounting for superannuation funds ar grossly inadequate. This is so because no Australian accounting standard relevant to superannuation funds, has statutory backing . Hence, for example, there is no statutory requirement for consolidating the accounts of any controlled entity such as the corporate trustee and no requirement for related party disclosures. Both of these are required in corporate accounting for the protection of shareholders and other relevant parties.

Australia's superannuation accounting standard (AAS 25) is highly controversial (eg. Robles and Tower, 1993; Scheiwe, 1993 & 1999). Because this accounting standard is so different in various ways, invalid comparisons are likely to be made between the performance of superannuation funds and that of other types of financial institutions, especially those which cannot recognise unrealised gains as income, and those that report returns based on net income , not gross income. For example, fund *investment* return must be reported (SISR 2.27(b)), but this can be very misleading because it can be quite different from the returns actually being derived by members for various reasons (Scheiwe, 1997). This is especially so for superannuants who in general, are deemed not to be financially literate (ARLC, 1992). Similarly, the crediting rate that must be disclosed on member's benefit statements can be quite different from the return derived by members because it ignores administration charges imposed on members. Clearly these anomalies put other types of deposit taking institutions at a disadvantage in the market for investment funds. This is especially so since shareholders have the benefit of daily stock market reports, ASX listing rules and

ASX monitoring, whereas superannuation fund members have no comparable facility. They also put superannuants at a disadvantage as compared shareholders.

(2) *Audits and auditors*

As outlined above, superannuation fund auditors report to trustees , not to members, and do not have the right to be heard at AGMs. The wording of superannuation fund audit reports also give a lower level of assurance than that for companies, because they use the term "present fairly" (meaning present in accordance with applicable accounting standards) not "true and fair view" (which means not misleading). Because of the reduced capacity of superannuants to monitor their funds, greater reliance is placed on superannuation fund audits than on corporate audits. Despite this, for 97.5% of funds, auditors need not be registered company auditors SISR 1.04(2)). In addition, they need not be members of a professional accountancy body (SISR, 1.04(2A)), though APRA does have the power to disqualify non-performing auditors (SISR 1.04(2C))

(3) *Regulation of trustees*

In at least half of the relevant cases, superannuation fund trustees are not even elected, but in extreme cases, trustees can be removed by APRA (SIS s.133). In contrast, company directors must face elections and would normally present their credentials as part of that process. In addition, the Australian Institute of Company Directors runs voluntary professional development courses for company directors. There are no experience or educational pre-requisites to the appointment of superannuation fund trustees. SIS simply disqualifies certain criminals from acting as trustees (SIS s.121).

(5) *Equal representation on trustee boards*

This requirement does not apply to excluded funds ie 97.5% of Australia's superannuation funds (SIS s.92, 93) but does affect the 98% of superannuants who are not members of excluded funds. Equal employee representation is better than no employee representation, but the Australian Law Reform Commission (1992) said that there is no justification for employer representatives on trustee boards of accumulation plans, and little justification for them in defined benefit plan boards. In addition, in many cases equal representation is not in members' best interests (Scheiwe, 1996).

For example, would think that employer representatives on trustee boards are there to protect employers' interests, not to protect employees' interests. Employers are likely to have an even greater share of board power in the many cases where their board representatives have more financial skills than employee representatives. Also, because SIS refers only to "appointment" not "election" of employee representatives, appointed employee representatives could in fact be employer representatives. In many other cases, employee representatives on trustee boards, are simply union appointees, despite the fact that unions represent only a small proportion of relevant employees. Such union appointees may have absolutely no superannuation expertise. Finally, there is no guarantee that so called "independent trustees" are not de facto employer representatives because of the distribution of power among the trustees who appoint such persons, and especially if such persons have a long history of being employer representatives.

(6) *Reporting*

Basically APRA does not want to know about fund problems unless the auditor and trustees cannot sort them out (SIS s.129, 130). Regarding reporting to members, what is reported is largely a matter for the trustees' discretion (SISR 2.27) eg. there is no statutory requirement to comply with the detailed disclosure requirements of AASB 1034 (which replaced the former Schedule 5). In addition, in some cases trustees can charge for the provision of information requested on an individual basis (SISR 2.06). Reporting exemptions also apply to some public offer funds. (s.327) There is inadequate monitoring of the reporting of funds, especially public offer funds with the result that some members have been told that they could not have information they are entitled to or were told to travel interstate to see it. Some have effectively received blank sheets of paper when they sought financial statements. Other asset statements simply show one asset – life insurance policies, in the same corporate group that operates the "superannuation fund".

(7) *Minimum benefit protection*

These provisions are intended to provide member protection against previous abuses of vesting clauses in trust deeds. Because of the way the provisions are drafted, they are a failure (Scheiwe, 1999) and so:

- cover only mandated employer contributions to funds (SISR 5.04 (2))
- still permit vesting schedules in defined contribution plans
- still permit abuses of reserving in defied contribution plans
- fail to protect some members of defined benefit plans against (deliberate) cross subsidisation between members (SISR 5.04(3)).

(8) *Delay in making contributions*

While SIS makes provision for reasonably prompt payment of contributions to funds (s.64) , the relevant SG provisions have never been proclaimed, with the result that SG contributions need only be paid annually. Not only does this put receipt of such contributions at greater risk because of the rate of small business failure, but also in ensures that any benefits members ultimately receive are much lower than they should be.

(9) *Surpluses*

Surpluses are the excess of a fund's assets over its "liability" for accrued benefits. In defined contribution plans they consist of (a) unallocated assets set aside by trustees for smoothing out benefit payments over periods of economic fluctuation, and (b) assets forfeited by employees who resigned before long vesting schedules ensured they derived the full contributions contributed on their behalf (plus relevant earnings). While SIS does set out a procedure for dealing with surpluses (s.117), members cannot stop their repatriation from defined benefit plans. There is also no protection regarding the calculation of surpluses and consequent manipulation of them eg for repatriation (Brown, 1992; Benedict, 1991). Employers have no basis for claiming a repatriation of surpluses from defined contribution plans.

(10) *Complaints*

Not only is the Superannuation Complaints Tribunal effectively defunct now, but also its powers were severely restricted from the outset by virtue of ss. 14 and 15 of the Superannuation (Resolution of Complaints) Act. This is particularly problematic since employees are not free to change funds.

(11) *Investing*

SIS (s.52) requires trustees to formulate and implement an investment strategy, but this does not increase the probability of optimum returns. That is because (a) usually trustees set investment targets extremely low (and applaud themselves in various ways when they achieve same) and (b) trustees can effectively ignore any written investment strategy (SIS s.31), provided the fund complies with the sole purpose test (SIS s.62).

Emphasising fund investment returns in annual reports is misleading because members may well receive a return far less than that because of fund operating costs (including insurance and contributions tax), reserving, and/or cross subsidisation. In addition, there is no readily available equivalent of the daily stock market report to allow members to compare and evaluate their fund's performance.

(12) *Act honestly*

Given human nature and the paucity of the relevant legislation, one would have to be an extreme optimist to think that a covenant requiring trustees to act honestly, will work eg. there is no statutory backing for applicable accounting standards and so there is no requirement to report on related party transactions. These would include income derived by trustees from company directorships obtained by them by virtue of relevant investments by their superannuation fund. At common law, such income belongs to the superannuation fund, not the trustee. Cases illustrating the ineffectiveness of this covenant bound eg. see specific reports of the Senate Select Committee on Superannuation regarding the Western Australian and Queensland state superannuation schemes.

(13) *Act in the interests of members*

This implies acting in the interests of ALL the members, not just some. The duty of impartially cannot be observed by trustees if they preside over defined benefit funds which involve cross subsidisation between members - as often they do. Similarly, the vesting of only employer mandated contributions means that eventually some

members of accumulation funds can receive far superior benefits than other members, especially in employer controlled funds. Finally, this covenant seems to create a conflict of interest for employer representatives on trustee boards.

On the basis of the above points, it is reasonable to conclude that the prudential safeguards do provide some protection for superannuants, but on balance are grossly inadequate. It can be further concluded that the prudential safeguards are unlikely to provide compensatory protection for superannuants needed because of their lower level of rights relative to other investors, such as superannuants.

Recommendations

Clearly there is a need to rectify the deficiencies outlined above. It seems that as a minimum, superannuants should have the same rights and protection as shareholders. To that end, the following are recommended:

(1) Choice

Superannuants should be given choice of fund, not just investment choice within a mandatory fund. That choice of fund should not be restricted as proposed by the Howard government and opposition parties. Choice of fund has been rejected by previous Labor governments and the current Labor opposition. Employers have argued in favour of electronic payment of wages and salaries into the bank accounts of each employee. Therefore it should be equally effective to handle superannuation contributions in a similar way. If necessary, changes requested by employees could attract a small once-off administration fee. Choice of fund would also eliminate the legalised robbery (to use the words of the ICAA superannuation spokesman) inherent in many defined benefit plans. The short termism argument against choice of fund lacks credibility in the medium and long term.

(2) Annual general meetings

Superannuation funds should have AGMs with superannuants having the same powers at them as shareholders have at company AGMs. Associated with this would be the abandonment of compulsory employer representation on trustee boards. Trustees would be directly elected by the members. Auditors would also be appointed by

members and report to same. Members should have the right to determine broad policy of the fund (in contrast to the present SIS s.58).

(3) Trustees

Trustees should be registered like auditors. A prerequisite to registration should be the completion of a meaningful course of study in superannuation. As part of an annual report, trustees should make declarations regarding related party transactions and compliance with trustee covenants. Trustees should have a duty to bring to the attention of members, any deficiencies or inequities in the fund.

(4) Accounting standards

AAS 25 should be completely revised and the proprietary approach to accounting adopted so as to reflect the contemporary superannuation paradigm referred to earlier in this paper. AAS 25 should be consistent with other accounting standards, recommendations, and GAAP. Reporting should be made more meaningful for members, by including more performance comparisons and evaluations. AAS 25 should be consistent with other accounting standards, recommendations, and GAAP. Reporting should be made more meaningful for members, and the focus should be on the return actually derived by members, not investment return. Full and more comparisons of performance should be reported to members via the internet.

It can be seen from the above that the number of changes needed to Australia's existing superannuation system is not great. Choice of fund eliminates several problems. The changes recommended may bring their own problems but change is necessary in order to optimise service and fund manager performance. Much of the present opposition to change is simply aimed at protecting large vested interests.

Need superannuants be treated so badly?

This section of the paper briefly describes a corporate fund that has to a large extent, operated along the lines recommended above.

Due to the increasingly poor results being generated by the public offer fund being utilised, the staff of Ashley and Munro, a Brisbane firm of Chartered Accountants, set

up their own corporate superannuation fund in May 1996. The fund is a trust, is an accumulation plan, and has 18 members. The policies of the fund state that the directors of the corporate trustee are elected by the members of the fund and are rotated annually. The directors are eligible for re-election if they so desire. It also states that all members hold equal voting rights.

The superannuation fund holds an annual meeting at which the full financial statements of the superannuation fund are reported to the members. The accounts and transcripts of all trustee meetings held during the year are available to the members of the fund to review and they are encouraged to query them. In accordance with SIS, members are also entitled to seek any information throughout the year. The auditor of the fund is selected and appointed by the members at the annual general meeting. The members of the fund have the right to approach the auditor and raise any concerns or questions.

The investment policy of the fund was originally determined by circulating a questionnaire to all members. This assisted the trustee in identifying the risk profile of the members. The investment strategy is referred to when undertaking investments, and the investments are monitored on a quarterly basis to ensure that he investment strategy is adhered to. To ensure currency of the risk attitude of the members, the investment strategy was reviewed after about 2 years.

The attitude of the trustees is that the fund belongs to the members, and consequently the majority of the decisions, investments and strategies of the fund should reflect the members' attitudes. Accordingly the fund takes an open and democratic approach to its operations. It not only complies with the minimum standards contained in the statutes, but also actively encourages participation and input from the members.

Not only has this plan complied with the minimum requirements contained in the relevant statutes, but also the trustees have adopted a far more open and democratic approach, as provided for in the relevant trust deed.

Conclusion

Superannuation is critically important to the Australian economy and to most Australian superannuants. Despite that, our system for regulating the industry and optimising and safeguarding superannuants' investments is incredibly deficient. It is undemocratic and completely inconsistent with our market based economy. Much of the regulation of the industry is more consistent with the outdated employer paradigm of superannuation than the more contemporary employee paradigm of superannuation. It has been said that there is very little fraud in the Australian superannuation industry. However, like the recent infamous denial of a USA president, it relies heavily on a legal definition. Many Australians are deriving sub-optimal returns from their superannuation funds (Ambrovich, 1994). In most cases that may not be as a result of fraud (per se), but certainly is the result of inappropriate behaviour on the part of those entrusted with the administration of the funds and those entrusted with the regulation of the industry. Consequently it is highly unlikely that the financial objectives of the federal government and of individual superannuants, will be achieved unless the system is reformed so that superannuants are treated more like other types of investors.

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Legislation

SIS Superannuation Industry Supervision Act, 1993

SISR Superannuation Industry Supervision Regulations

SRC Superannuation (Resolution of Complaints) Act, 1993

Superannuation – a second-rate sector?

Accountability score: Companies 1, Super funds 0

It is in the interests of the individuals involved, the Australian government, and many employers that Australia's superannuation system should work optimally. DAN SCHEIWE suggests that the accountability of superannuation management is considerably less than that of corporate management and that this works against satisfactory performance.

[illegible] SCHEIWE [illegible]

The external reporting requirements for Australian companies have evolved over a long period and generally have been introduced in response to practices which were detrimental to shareholders and/or debt holders. Thus the assumption underlying the evaluation in this paper is that if the external reporting requirements for companies are more demanding than those for superannuation plans, then it is possible that relatively more detrimental practices may occur in the superannuation sector than have already occurred in the corporate sector. Put another way, if experience has suggested that certain regulations should be in place for companies, then *prima facie* it is difficult to see why similar regulations should not exist for superannuation plans.

This paper compares the accountability of companies and superannuation plans to their members. Relevant points are summarised in Table 1. The points in the following discussion are numbered to correspond with the left-hand column in the table.

(1) While shareholders can choose which companies they invest in and have the option of simply selling their shares if they so desire, most superannuants have no choice about which superannuation plan they join or whether they join at all. This was true of many public servants and is now the case for most employees because of the superannuation guarantee (SGC) legislation. Approximately 97% of full-time employees are now involuntary members of prescribed superannuation plans as a result of SGC. Thus the relevant market force is not free to operate and promote optimal performance.

Despite that involuntary membership, members should still be entitled to information on the performance of their plan since they have the right to competent plan management.

TABLE 1 Comparison of corporate and superannuation accountability in Australia *(Section references are to the Corporations Law)*

		Corporations	Super funds
1	Members choose to invest	yes	often no
2	Full accounts sent to members	yes	no
3	Directors' report	yes	no
4	Directors' statement	yes	no
5	Public performance reports	yes (ASX)	no
6	Auditor's report to members [s.113(4)]	yes	no
7	Auditor appointed by members [s.113(2)]	yes	no
8	Notify if auditor resigns	yes	no
9	Annual general meeting	yes	no
10	Members convene meetings	yes	no
11	Members elect directors	yes	usually no
12	Members vote out board	yes	no
13	Third parties on board [s.108]	no	yes
14	Members set directors' pay	yes	no
15	Members veto major decisions	yes	no
16	Statutory accounting standards	yes	no
17	Unrealised gains recognised	no	yes
18	AASB 1034 or equivalent	yes	no
19	Disclosure of directors' pay	yes	no
20	Additional regulation by ASX	yes	no
21	Statutory model set of rules	yes (Tables A & B)	no
22	Public database of information	yes	no
23	Pro-active statutory watchdog	yes (ASIC)	no (APRA)
24	Provisions re oppression	yes	no

(2) Unless they make a specific request, superannuants do not receive a full copy of their plans' annual accounts and do not vote on whether to accept the accounts. They automatically receive summary accounts in lieu of full accounts (SIS reg. 2.29). These need not be audited.

The premise underlying this situation is that superannuants are not financially literate. Many shareholders, too, are financially illiterate, but they automatically receive full financial statements from their companies (Corporations Law s.315) on the assumption that they can take them to someone for interpretation. There is no valid justification for the lower level of accountability by superannuation plans. In addition, it could be argued that the understandability problem lies not with the superannuants but with the financial statements. One option is for them to be presented in a form that is more easily understood (eg, Atrill, Harvey, McLaney and Scheiwe 1996).

(3/4) The trustees do not report to members in the same way as directors do through the prescribed content of their directors' statements and directors' reports (Corporations Law s.301 and s.305 respectively), although the trustee is required to report what he or she considers to be significant events to members (SIS Regs. 2.32-2.36). This is a lower standard of reporting by superannuation plans, for which there is no justification.

(5) There is no ready access to a public database through which superannuants can compare and evaluate the performance of their entities. In contrast, the performance of listed companies is made public through newspaper reports, the financial press and the ASIC database, and is reflected in share-price movements reported in the newspapers daily. There is no comparable arrangement for superannuation plans.

Trustees have argued that such information is confidential. Thus an ISC computerised public database on superannuation plans provided only their names, addresses and phone numbers and their complying or non-complying status. Given that the objective of financial reporting, according to SAC 2, is to provide information useful in making and evaluating decisions about the allocation of scarce resources, the lack of a ready basis of comparison is unsatisfactory, especially when same is available for companies.

(6/7) Unlike company auditors (see Corporations Law ss.327, 331A), superannuation plan auditors are not appointed by members and do not report to members; rather they are appointed by and report to the trustees (s.113). Company auditors have a statutory right to be heard at company annual general meetings (Corporations Law ss. 329, 332(8)) and are required by their profession's standards to exercise that right in certain circumstances (eg, AUS 212). The absence of that right and option for superannuation plan auditors constitutes a lower level of reporting for superannuation plans and therefore is unsatisfactory.

(8) Company auditors are required to obtain ASIC approval before resigning (Corporations Law s. 329(5)), and to justify their decision to resign. This came about to stop auditors from resigning to avoid issuing adverse audit reports. Superannuation auditors do not have to obtain APRA or ASIC approval to resign and do not have to justify their decisions. Clearly a lower standard of accountability exists for superannuation plans than for companies.

(9) Unlike companies (Corporations Law s. 245(1)), there is no provision for annual general meetings of superannuation plan members. Given the assumption that superannuants are less financially literate than shareholders, arguably the former have a greater need for members' meetings so that they can hear and learn from informed debate about the concerns of people more knowledgeable about superannuation. The absence of member meetings is a major deficiency in the regulation of Australian superannuation.

Members can request that the trustee provide information but those who identify problems with their plan cannot readily inform fellow members and gather their support for appropriate changes. Thus it could be said that the regulations deny members the benefit of the synergism of AGMs, promote the principle of divide and rule and impose a lower standard of accountability for superannuation plans. This is unsatisfactory.

(10) Under the Corporations Law, shareholders can convene meetings of members (s.247(1)). No such right exists for superannuants. Thus there are no automatic AGMs and no other general meetings of superannuation plan members. Clearly this is a lower standard of accountability and therefore unsatisfactory.

(11-13) If superannuants are dissatisfied with the management of their plans they are not able to vote out trustees; in comparison, shareholders can vote out directors (Corporations Law s.227). Superannuants usually do not elect the trustees (ie, the directors of the corporate trustee). The shares in the corporate trustee are often held by the sponsoring employers and, at best, a consultative committee of members elects most of the directors. Unfortunately consultative committees need only be consulted by the trustees if they deem that necessary.

Employers have a statutory right to half of the members on the board of the corporate trustee (SIS s.89) and are apt to exercise control by virtue of greater expertise in superannuation matters than the employee representatives. There have been calls for the abandonment of the SIS requirement for employer representation on trustee boards (eg, ALRC 1992, Scheiwe 1997) in light of the fact that superannuation is widely regarded as salary sacrifice (eg, Benedict 1991, ALRC 1992, ASFA 1995, Dawkins 1992, Institute of Actuaries in Australia 1992, ASCPA 1991).

In addition, trustees can elect an independent trustee themselves, with superannuants usually having no direct vote on the matter (SIS s.89(2)). If trustee boards are employer-dominated then there may be cause to doubt the independence of "independent" directors so elected and doubt about whether the plan is being administered impartially in the interests of all members. Clearly market forces cannot operate under these circumstances yet APRA claims to be relying on a "market oriented" regulatory system. The situation is unsatisfactory.

(14) Shareholders have a statutory right to set directors' remuneration at their companies' AGMs. No such right exists for superannuants. This is unsatisfactory since market forces are not free to operate.

(15) Shareholders can veto major decisions by directors by convening meetings and setting parameters within which directors must work, or by voting to reverse decisions previously made by directors. No such option exists for superannuants. However, trustees are required to establish an investment policy. These are unsatisfactory because they are not binding; they are set by the trustees; and agency theory would suggest that they will be drafted so broadly as to be of no consequence (eg, investment goals set very low).

Thus many superannuants are forced to invest in superannuation plans but have virtually no say about the way they are run. This not the case for shareholders.

Clearly the superannuation requirements are unsatisfactory.

(16) Under the Corporations Law (s.285) companies are required to use applicable accounting standards in preparing corporate accounts. No such statutory provision applies to superannuation plans even though a relevant (but controversial) accounting standard (AAS 25) exists. Thus, for example, if a plan had a corporate administrator as well as a corporate trustee, the plan would not be required to disclose related-party information. This is a lower standard of accountability and therefore is unsatisfactory.

(17) AAS 25 requires superannuation plans to recognise unrealised gains on assets as income, even if they are non-trading assets. This is not so for companies and makes comparison of performance misleading. As a consequence of this accounting advantage, superannuation funds may attract investments that they should not receive, thus denying members optimal retirement benefits. This conflicts with the qualitative characteristics that SAC 3 states are desirable in financial information, and so is unsatisfactory.

(18) AASB 1034 sets out statutory disclosure details for companies. No such statutory details are set out for superannuation plans. This is a lower standard of accountability and is unsatisfactory.

(19) One of the requirements of AASB 1034 is disclosure of company directors' remuneration. In addition, shareholders can require full disclosure of directors' emoluments (s.239). No similar requirements exist in relation to superannuation plans. Clearly the difference is unsatisfactory.

(20) Companies wishing to be listed on the stock exchange have even more disclosure requirements than those set out in the Corporations Law for other public companies. No such requirement exists for superannuation plans even though large plans are similar to listed companies in that they have a multiplicity of "investors".

(21) Companies may adopt or vary a model set of articles (the former tables A and B are now referred to as replaceable rules). These imply what constitutes best practice. No such model of best practice regarding superannuation trust deeds is provided by the relevant legislation. Such a model is very desirable because it would force public debate about the more ignominious aspects of many existing superannuation plans.

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(22) In addition to maintaining a public database of financial information about many companies, ASIC also maintains in that database other types of information about those companies and makes it available to the public. No such public database exists for superannuation plans.

(23) The number of prosecutions of company officers by ASIC (see annual reports) suggests that companies are regulated by a reasonably proactive regulator (ASIC). In contrast, the former ISC seems to have been far less proactive, based on the number of attempted prosecutions disclosed in its annual reports. In addition, ASIC has a company auditor surveillance program to ensure that relevant audits are properly carried out and that the corporate financial statements are credible (Adams and Fonti 1996). In contrast APRA only did this as part of its review of a small proportion of funds.

Given that they are assumed to be less financially literate than shareholders (Hubbard 1982, Senate Select Committee 1992), it seems that superannuants need a greater degree of regulatory protection than shareholders.

(24) Superannuation plans contain various biases (Scheiwe 1993, ASFA 114 1995) which may disadvantage some members. Disadvantaged members can complain to a Superannuation Complaints Tribunal but this body has very limited powers under ss. 14-15 of the Superannuation (Resolution of Complaints) Act. This act was also successful;ly challenged recently on the ground of constitutional validity. In contrast, the Corporations Law contains provisions regarding oppressed shareholders (s.260) and their right (*inter alia*) to sell their shares back to the oppressor company. No similar provision exists in relation to superannuation plans.

CONCLUSION

Compared with the regulations that apply to companies, the present system of accountability for superannuation plans in Australia appears to have substantial deficiencies unless it is believed that superanuation trustees are more trustworthy than company directors.

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Why Australia's superannuation benefit protection standards are a farce.

1.0 Introduction

This paper shows that the benefit protection provisions in Australia's superannuation legislation fail to provide the protection that their name implies. This paper is directed only at benefit protection standards per se and other closely associated provisions. It does not attempt to consider other prudential safeguards in the relevant superannuation legislation. They will be covered in a separate paper.

2.0 The minimum benefits standards (SISR Division 5)

Superannuation Industry Supervision Regulation (SISR) 5.04 makes provision for minimum benefits in regulated superannuation funds.

In defined contribution (accumulation) plans (DCPs) minimum benefits are (SISR 5.04(2)):

(a) member financed benefits (member contributions), plus

(b) mandated employer contributions (employer contributions under SG legislation or an industrial award or agreement), including

(c) by virtue of the definitions in SISR 5.01, the net investment earnings on both employee and employer contributions.

In defined benefit plans (DBPs), minimum benefits are the same as above unless "... the member belongs to a class of employees in relation to which a relevant benefit certificate applies, [in which case, minimum benefits are] the amount of the member's minimum requisite benefit" (SISR 5.04(3) - emphasis added).

Benefits that have been rolled over or transferred into a fund are also minimum benefits.

Given that politicians tend to be tardy reactionaries rather than being proactive reformists, one can only deduce that minimum benefit provisions were introduced to counter inequitable practices such as long vesting schedules which were often used to benefit some superannuation fund members at the expense of others. However, the minimum benefits provisions are a failure because they do not preclude earlier abuses of superannuants eg. AAS 25 (para.24) still refers to "forfeited benefits". This is because the protection that members should derive on their equitable interests in their superannuation funds is buried in legislation worded in a way that facilitates deception and deprival of the reasonable benefits intended by the relevant Division of SISR.

The "investment earnings" which form part of minium benefits (see SISR 5.04(2) above) are defined (SISR 5.01(1)) simply as whatever the trustees credit to each member's account (net of relevant costs). Provided fund operating costs are at a reasonable level, there is nothing wrong with that in a DCP which does not maintain reserves.

For DCPs that do maintain reserves, SISR provides that trustees are to determine the investment return to be debited or credited to a member's benefit from time to time, having regard to the return of the fund on investment, costs, and level of reserves (SISR 5.03(1)). Thus unscrupulous trustees are still empowered to operate inequitable schemes eg. build up reserves in a DCP under s.115 and eventually pay far superior benefits to a select few people left in a fund after other members/employees have been "dispensed with" in various ways. Such arrangements would be very similar to notorious cherry picker schemes that had long vesting schedules (see Batrouney, 1991).

Similarly, in DBPs, if members are not covered by a relevant benefit certificate[1], minimum benefits also include investment earnings on both member contributions and mandated employer contributions ((SISR 5.04(3)). As is the case for DCPs, SISR 5.01(1) provides that investment earnings for DBPs means whatever the trustees credit

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[1] Benefit certificates are issued to show that employer contributions in DBPs are (are not) meeting relevant SG obligations

to each member's account by way of an investment return. However, "investment return" is defined (SISR 5.01(1)) differently for DBPs than for DCPs. For DBPs there are 3 possibilities:

(a) a proportionate share of the return on investments (based on benefits), or

(b) "the return on the benefits over that period that is fair and reasonable to all members of the fund, being a return based on either the actual return earned on the investments of the fund or on a commercially available rate of interest , or

(c) the return on the benefits that is derived by increasing the benefits in proportion with the increase in the salary of the member over that period.

Option (a) above is comparable to the fairest option available to DCPs (ie. no reserving). Option (b) is comparable to the DCP arrangement which permits the build up of reserves which can be dealt with in a variety of ways, including inequitable ways similar to cherry picker schemes. However, option (c) clearly empowers trustees to engage in cross subsidisation between DBP members, thus depriving the majority of members of optimal returns so that a minority of members derive returns (considerably) in excess of most members of the same fund. This has been an on-going problem, especially in the current prolonged period of wage restrain for most Australian employees. Benefit cross subsidisation occurs in (funded) DBPs because benefits are based on final average salary or highest average salary (for a detailed discussion, see Scheiwe, 1996 a & b, 1997 a & b). Clearly this is inequitable and contrary to the intended purpose of the benefit protection legislation.

The industry explanation/justification of cross subsidisation is that in a DBP, employer contributions are made to a pool of funds, not made on behalf of individual members. Consequently (it is argued), the pool of funds (plus earnings on same) can be used for cross subsidisation purposes. This is contrary to the understanding of many superannuants and clearly disadvantages many DBP members relative to DCP members, especially in times of government and employer restrain on salary increases for the majority of relevant employees. Unions which do not act on this problem are failing their members, and arguably trustees are in breach of the covenants to act in the best interests of [ALL] members and to act honestly (SIS s.52(2)). Given that

senior management are best placed to take advantage of this DBP loophole, it also seems highly desirable to review the right of employers, to equal representation on (relevant) superannuation trustee boards (see Scheiwe, 1997c).

3.0 SG contributions can be over a year late, but the benefit protection standards are silent

While s.19 of the Superannuation Guarantee (Administration) Act (SGA) implies that superannuation guarantee payments are to be made quarterly, the relevant legislation has not been promulgated and so relevant payments need only be made annually - by the 28th day after the end of the relevant year (SGA s. 23(6A)). This means that:

(a) as compared other remittances which are due within 28 days of the end of the month in which they have been withheld from employees or are otherwise due, SG contributions can be over a year after effectively being deducted from employee wages[2] ie. over a year late.

(b) no investment income is derived on those contributions for the first year and thus this means a significantly lower final benefit for members. For example, $1 per year invested at 5% for 40 years accrues to $120.8 while the same investment for 39 years accrues to $115.1 ($114.1 plus $1 contributed in year one). Thus a significant difference in final benefit results.

(c) because of the delay in remittance of SG contributions, employee superannuation contributions are at greater risk especially given the high attrition rate for small businesses.

Clearly the relevant legislation fails to protect many superannuants adequately in this regard.

4.0 The benefit protection standards are silent regarding overly conservative investment plans which result in sub-optimal benefits

SIS s.52(2)f requires trustees to "formulate and give effect to an investment strategy that has regard to (sic) risk, diversification, liquidity, and fund liabilities. This

[2] Various sources suggest that all superannuation contributions are deferred employee income eg. Dawkins, 1992

provision has been applied in conjunction with the sole purpose test (SIS s.62) to protect superannuants eg. from:

(a) unscrupulous employers who seek to use the funds as a personal source of finance for their businesses (despite the restriction on in-house assets) or for their pleasure.

(b) honest but bad investment management of superannuation funds eg. the case the trustee of an excluded fund who had a penchant for playing the stock market, much to the detriment of the fund's assets, and in another case where the trustees invested in only two areas, one of which did not appreciate and the other was badly affected by the Asian financial crisis. In both cases the trustees did not diversify the investments because they thought they could generate superior returns from specialised investments.

However, without the exposure to normal market forces, trustees can also aim to badly err on the side of caution, and so relevant superannuants will derive sub-optimal retirement benefits. This is so because of the apparent lack of concern in s.52(2)f(ii), with investment return, especially low returns caused by overly cautious investment plans. This is relevant to benefit protection because of the importance of investment return to the ultimate size of benefits derived (eg. Hely, 1990). The Institute of Actuaries in Australia has expressed its concern about one facet of overly conservative superannuation investment policies, in publicity regarding short termism (IAIA, 1996). An ad hoc review of the investment objectives of selected funds that do comply with s.52 shows that trustees commonly set very low investment goals and applaud their own management (in various ways) when those objectives are achieved.

Freedom of choice of fund would put pressure on trustees to strive for optimal returns. Similarly, the lack of control over fund operating costs (eg. trustee remuneration, trustee travel and other trustee perquisites) also contributes to sub-optimal returns for Australian superannuants.

Except where it is apparent that trustees are in breach of the sole purpose provision, APRA appears to be powerless to enforce the investment plan provision. In fact,

s.52(2)f(ii) appears to say "anything goes, as long as the return matches the risk", and there is "adequate" diversification.

One reason for this inability to enforce the provision is that there are no criteria provided to determine what is adequate diversification, and even if there were, in some cases diversification is impossible because the relevant plan has insufficient funds. Therefore, since the legislation gives trustees the right to set (and alter) investment plans, provided they have done that, there is little that APRA can do if they disagree with the trustees' judgement.

What is the solution?

In addition to lack of choice of fund, there is no justification for Australia's superannuation legislation not requiring annual general meetings of superannuation funds at which members could exercise rights similar to those of company shareholders eg. expressing their preference regarding investment strategy, electing trustees, setting trustee remuneration, receiving the auditor's report, asking questions, etc. Similarly the current provisions regarding "appointment" of trustees and the composition of relevant boards is inconsistent with Australia being a democracy. At best, Australia's superannuation guarantee provisions were an interim arrangement partly to gain union support for a retirement incomes tax (ie. compulsory superannuation).

5.0 Benefit protection standards don't prevent employers from effectively contributing less than their mandated contributions

S.117(4) of SIS permits trustees to pay employers for management services. "Management services" is undefined in SIS, but presumably it would include collection and remittance of contributions, associated reconciliations, answering employee inquiries regarding superannuation, etc. Traditionally such management services were not paid for by employees. They were regarded as part of the cost of employing staff. Since employers can now charge superannuation funds for those

services under SIS s.117, effectively this reduces the superannuation contribution of employers below what they may have agreed to under relevant awards or agreements.

Similarly, where cross subsidisation occurs with funds (eg. in DBPs and in some DCPs that use reserving), many fund members are not deriving the full nominal employer contributions to their superannuation and so their retirement incomes are less than would otherwise be the case.

In addition, the minimum benefit provision (SISR 5.04) relates only to employee and **mandated** employer contributions. Hence, where employees do not work under an award or their remuneration package includes above award superannuation contributions, there is no relevant protection available. For example, with long vesting schedules, at least some of the employer contributions could be forfeited on resignation. Vesting schedules are still alive and well despite the plethora of superannuation legislation (eg. benefit protection) and so called prudential safeguards.

S.117(5) sets out special procedures for payment out of an employer sponsored fund to an employer sponsor, but even these can be waived by APRA. This provision is applicable to the repatriation of surpluses. Under the above provision, surpluses can be repatriated provided (sic) that (a) the trustees (half of whom are employer representatives, and possibly more financially aware than their employee counterparts) so resolve (b) an actuary certifies that the fund would not become insolvent as a result of the repatriation (c) 3 month's notice of the repatriation was given to the members (d) the trustees (usually unelected) again resolve to repatriate the amount after the 3 month period. Since members cannot direct the trustees (except in excluded funds) clearly most members are powerless to stop the repatriation under this provision. To make matters worse, the size of any surplus is open to manipulation because its calculation is dependant on various assumptions. This unscrupulous manipulation and repatriation of surpluses led the superannuation spokesman for the Institute of Chartered Accountants in Australia to refer to it as "legalised robbery" (Brown, 1992). Benedict (1991) also referred to employer abuse of the surpluses in the USA. However, the relevant assumptions don't even have to be manipulated for the surplus

repatriation to be unfair. All that is required is for the rate of return implicit in the defined benefit formula to be low and hey presto, even with modest investment returns, there can be a surplus which is available for repatriation. In such circumstances most members of relevant funds will derive sub-optimal retirement income.

6.0 The benefit protection standards are undermined by secrecy provisions which protect delinquent trustees rather than members

Both APRA and the ATO have very limited resources to monitor the management of superannuation funds. This is evident from the small proportion of funds that APRA reviews (see ISC annual reports). Similarly the ATO is almost fully occupied with responding to employee complaints about SG contributions and so they have not been able to implement a program of proactive monitoring of relevant contributions.

However, even if APRA reviews a fund and is dissatisfied with its management, until 1.7.98 it could not report to members because of the secrecy provision in SIS, namely s.346. Similarly employees cannot check with the ATO whether their employers have made relevant SG contributions because of the secrecy provision in the Superannuation Guarantee Administration Act (s.45).

If members determine that their SG contributions have not been paid, it appears that until recently they are reliant for recovery of same, on one understaffed ATO collection unit for all Australians. It operated out of Mooney Ponds (Melbourne). For example, the staff of a health care facility (only one of several operated by the same person) have complained to the ATO for years that their SG contributions had not been paid to the relevant fund. The employer says s/he cannot afford to pay same and some staff adopt the attitude that they prefer to keep their jobs rather than pursue the SG contributions. Several years ago this employer undertook to make the payments but so far only one year's payment has been made. Such cases make a mockery of the SG system and the government's retirement incomes policy.

7.0 Who will enforce the benefit protection standards?

Transfer of the regulation of self managed superannuation funds from the Australian Prudential Regulation Authority (APRA) to the Australian Taxation Office (ATO) strongly suggests that the government's primary concern in relation to those funds is preventing "loss" of tax revenue rather than protection of members' funds. The restriction on membership of self managed funds (as compared excluded funds) appears to assume that members will be protected by virtue of them all being family members or by all fund members being trustees. This will prove to be wishful thinking in many cases. Given that at present some 96% of Australian superannuation plans are excluded funds, it appears likely that the superannuation benefits of many Australians will not be adequately protected by the relevant legislation because there seems to be no one assigned to enforce it for self managed funds.

In addition, s.5 of the Superannuation (Resolution of Complaints) Act (SRCA) precludes members of excluded funds from referring matters to the superannuation complaints tribunal. Thus another (SCT) "protection" is/was denied to members of approximately 96% of Australia's superannuation funds

For members of other types of funds, the situation was little better because the Superannuation Complaints Tribunal was knobbled even before it was ruled unconstitutional. Section14 of SRCA set out some of the restrictions on complaints which the SCT could hear. For example, s.14(6) did not permit the SCT to hear complaints that "... relate to the management of the fund as a whole". This augments the divide and rule approach inherent in Australia's superannuation legislation, thus sustaining sub-optimal fund performance, to the detriment of final benefits. Similarly s.14(2) restricts complaints to decisions made by the trustees, thereby precluding complaints about unfair aspects of (mandated) superannuation arrangements.

The whole matter of resolution of complaints is protracted by s.19 which requires the relevant parties to have tried for up to 90 days to try to resolve their dispute. After that the SCT must first try conciliation before making a ruling on a dispute.

Even if the SCT were not restricted to a conciliation role because SRCA was ruled unconstitutional (in part) in 1998, the SRC provisions discussed above are scarcely virile benefit protection measures and Division 5 of SISR contains no compensating benefit protection provisions.

8.0 Conclusion

This paper has focussed on SISR Div. 5, even though other benefit protection measures are supposed to be contained in Australia's superannuation legislation. For example it has not attempted to review the prudential safeguards which are also supposed to protect superannuation benefits. Despite that self imposed limitation, this paper has highlighted some major gaps in the protection of superannuation benefits in Australia.

Thus this paper shows that despite OSSA being replaced by SIS, Australia's superannuation legislation is still grossly inadequate in terms of protecting superannuants and achieving stated government objectives for retirement incomes.

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Should employers have equal representation on superannuation trustee boards?

Dan Schiewe

Abstract

Administration associated with employee superannuation places considerable demands on employers' time. For example, s 89 of *the Superannuation Supervision Act 1993* (the SIS Act) requires equal employer representation on the boards of the corporate trustees of standard employer sponsored superannuation plans. Whether the current level of employer involvement is justified is debateable. The Australian Law Reform Commission (ALRC) questioned the necessity for such representation in 1992. This article considers arguments for and against substantial employer representation and concludes that it is not justified. Inviting experts from private practice onto boards may be a better alternative.

Introduction

Section 89 of the SIS Act requires equal numbers of employer and member representatives on the boards of the corporate trustees of standard employer sponsored superannuation plans in Australia. The Australian Society of Certified Practising Accountants has supported that requirement (Australian Society of Certified Practising Accountants, 1991). The equal employer representation requirement appears to have arisen from the belief that 50 per cent member representation is better than no member representation as was the case in schemes subject to the prescribed interest provisions of the *Corporations Law* (ALRC, 1992, p 105). However, there are reasons to question whether employers should have any representation on the corporate trustees of those plans, let alone a statutory right to equal representation. For example, the ALRC (1992, pp 106107) took the view that:

> Employer representation on the board of a defined benefit scheme is clearly appropriate, as it is the employer who bears the investment risk of the scheme. The case for employer representatives on the board of an accumulation scheme is far less clear, given that the investment risk in such schemes is borne by the members ... However, the Review raises for comment the issue [of] whether the representation of employers on the boards of accumulation schemes should be phased out in the future.

The above comment with respect to defined benefit plans (DBPs) is presumably based on the assumption that the employer actually guarantees the defined benefit, rather than simply undertaking to consider topping up the fund should it be unable to finance the defined benefit.

This article considers arguments for and against employer representation on corporate trustees of Australian superannuation plans.

Arguments in favour of substantial employer representation

There are several possible arguments in favour of substantial employer representation. These are discussed below in random order.

In the case of DBPs in which the employer actually guarantees employee benefits, the employer largely bears the financial risk. Therefore it is understandable that the employer would want to, and would be entitled to, minimise that risk by ensuring that the plan is well managed. To the extent possible, that could be accomplished in the past by the employer unilaterally managing the plan. There may have been no legal impediment to that arrangement since most superannuation plans are trusts (Quinlivan 1994, ALRC, 1992) and the only relevant legislation was state trust law which was drafted with deceased estates in mind, not perpetual trusts with thousands of members (ASFA, 1995). Various abuses of employers' power of unilateral management occurred and so eventually the legislation provided for equal representation. So s 89 may be more concerned with increasing member representation to 50 per cent than preserving employer representation.

A second reason that employers may want, and may to some extent be justified in wanting, ➢

substantial representation on trustee boards of DBPs, is that the courts have tended to rule that surpluses belong to employers (for example, Batrouney, 1991). In many cases those surpluses have been repatriated to employers (for example, Benedict, 1991). Thus employers may want to be closely involved in the management of the DBPs they sponsor in order to minimise the cost of funding them, and to maximise any surpluses capable of being repatriated. A counter argument is presented below.

A third reason (but not necessarily a justification) for substantial employer representation on trustee boards is the notion that superannuation is merely an extended remuneration system whereby employers selectively reward employees. If that notion is accepted it follows that employers should be able to control plans, particularly with respect to distribution of benefits. To a large extent employers give up that opportunity if they sponsor defined contribution plans. The only way employers can influence distributions from those plans is by contributing more or less for different employees.[1] However, it also follows from the extended remuneration notion that employer contributions to DBPs constitute a general fund/resource that employers can deal with at their discretion in order to achieve their objective of selectively rewarding employees. This can be accomplished more readily in DBPs because members with the highest rates of salary increase (especially in the last few years of employment) can derive large increases in superannuation benefits which may be quite disproportionate to the additional contributions made by them and/or on their behalf by their employers (Scheiwe, 1994). Thus employers make decisions about salary increases (through promotions, bonuses, loadings etc) which in turn result in increased superannuation benefits. Where employers do not make additional contributions to fund the increased benefits for the select few, they can only be funded by cross-subsidisation by

> *'[In] DBP's ... members with the highest rates of salary increase (especially in the last few years of employment) can derive large increases in superannuation benefits.'*

the majority of members in relevant plans. Why do employers need to be on the relevant trustee boards? To make sure that the trust deed is not amended to curtail their indirect control of plan distributions.

The final argument supporting substantial employer representation is rather quaint, but does appear to premise some attitudes to superannuation. It is the notion that superannuation is a discretionary benefit magnanimously bestowed on employees by benevolent employers. Therefore, if employer contributions to superannuation plans are simply gratuitous (see for example *Borst v Chevron Corp*, US Court of Appeals, Fifth Circuit, 1994) employers are in a strong position to retain control of the plan. While superannuation pensions may have had their origin in benevolent employers providing for long-term employees during their old age, that is scarcely the extant status of Australian superannuation. Thus the opposite view is discussed and supported below.

From the above, it appears that employers have no common law or statutory right (except for s 89) to representation on trustee boards of Australian superannuation plans which they sponsor. At best, their representation can be justified on moral grounds alone, and even then only in DBPs because they have contracted to guarantee the defined benefit and the courts have ruled that they own any surplus. Therefore, by being on trustee boards they can maximise any surplus, for example, by minimising plan costs.

Arguments against substantial employer representation

Given that most superannuation plans are trusts (Quinlivan, 1994; ALRC 1992) whose only beneficiaries are the plan members, employers have no legal interest in them and accordingly have no legal right (except for s 89) to participate in their management. Superannuation trusts are separate legal entities from the sponsoring employers. Once money has been transferred to those trusts by employers and employees, neither has a legal

interest in the relevant trusts. If employers have overfunded the schemes they sponsor then they can take a moratorium on contributions, permanently reduce contributions, or ask for the excess to be returned. If necessary and justified, they can take legal action to recover same. Employers' statutory right to representation on trustee boards despite the absence of any legal interest in the relevant superannuation plans, is particularly poignant in defined contribution plans generally, and in defined benefit plans where the employer does not guarantee employees' benefits. The self protection argument above is not valid in those cases.

It has been argued that on average superannuants are not financially literate (for example, Hubbard, 1982; Australian Senate, 1992) and that they would benefit from having more financially literate employer representatives on their boards. There is some merit in that argument but it does not justify a 50 per cent representation and in any case, there is no guarantee that the employer representatives will be more financially literate, particularly in superannuation matters. In fact, it is unlikely to be the case if employers see their representation on such boards as the government forcing them to act as financial monitors in the same way that they are forced to act as unpaid tax collectors under the PAYE system. Alternatively, it seems that persons with appropriate expertise could be invited onto relevant boards, either from among employers or from private practice. If one accepts the paternalistic notion that employers should have a statutory right to participate in the management of employees' superannuation, why not also legislate to make them counter signatories on employee bank accounts, and controllers of their credit cards and family budgets? The financial expertise argument is not a valid reason for giving employers a statutory right to substantial representation in the management of employee superannuation plans.

'Counter to the notion that employer superannuation contributions are benevolently bestowed on employees is the view that they are in fact part of employee remuneration.'

Any argument that employer representation on trustee boards may result in more informed and balanced decision making can also be rejected on the above grounds.

Counter to the notion that employer superannuation contributions are benevolently bestowed on employees is the view that they are in fact part of employee remuneration — that is, deferred income (Benedict, 1991; ALRC 1992; ASFA, 1995; Dawkins, 1992; Institute of Actuaries in Australia, 1992; ASCPA, 1991). For example Benedict (1991, p 32) reported research which sought to determine the current salary/superannuation trade off in the US. Using the spot market model, the trade off was calculated as 27 cents of wages, and using the implicit contract model, the trade off was calculated as $1 of wages, for each $1 increase in pension. In Australia, the federal treasurer said in relation to SGC (Dawkins, 1992):

> No loss of total remuneration is involved in meeting this challenge. What is involved, rather, is foregoing a faster increase in real take home pay in return for a higher standard of living in retirement (p 17) ... the government has amended the *Industrial Relations Legislation Act 1988* to require the Commission to have regard to SGC contributions in determining national wage cases (p 40).

Clearly that indicates that in Australia, SGC payments by employers may constitute a wages trade off and there is no reason to believe that other employer superannuation contributions are not wage trade offs as well. That view is supported, for example, by:

1. The Institute of Actuaries (1992, p 2) which states that:

   > Members of the more recent award superannuation funds look upon benefits as pay which has been directed into a form of quasi bank account.

2. ASFA (1995) refers to employer contributions to superannuation plans as 'a trade off for wage constraint'.
3. The ASCPA (1991) supports the view that employer superannuation contributions are wages.
4. The Australian Senate (1992) supports the view that employer superannuation contributions are part of employee remuneration.
5. The existence of award superannuation.

6. The court decision that superannuation is an industrial relations matter (for example, Davis, 1992).

Given that superannuation funds constitute deferred income that has been earned by employees and paid to their agents, there is no justification for any further employer involvement after relevant payment, unless, for example, the employer has undertaken to fund benefit shortfalls (for example, resulting from unfulfilled actuarial assumptions, fraud or bad investment) or to guarantee a defined benefit.

While it has been conceded above that there may be some justification for employer representation on trustee boards of DBPs on the grounds that the courts have ruled that employers 'own' surpluses,[2] the strength of that argument may be diminished if a more contemporary view were taken of what a surplus is. To date an employer/contractual view of what constitutes a surplus has been used, but there is a strong argument for using an employee/equity view (see Scheiwe, 1995). In addition, there has been strong criticism of the extant method of measuring surpluses, because it permits very substantial manipulation of the reported amount (for example, Brown, 1992; Lusk, 1992). If the alternative method were used then the scope for manipulation would be substantially reduced and many reported surpluses would be reduced or disappear. Thus that alternative approach would substantially reduce the surplus argument for substantial employer representation on relevant trustee boards.

Superannuation is regarded by many people as an investment for retirement (for example, ALRC pp 29, 58). Therefore it is reasonable to ask why superannuants should not have the same or similar rights in respect to their retirement investment, as they have for other investments. In the case of direct investment in shares, one of those other rights, is the right to elect ALL the directors of the relevant companies.[3] Under present legislation, at best, superannuants can elect only half of the directors of their corporate trustee. The ASCPA (1991) supports the view that superannuants should have the same rights as shareholders. Given that on average, superannuants are assumed not to be financially literate (Hubbard, 1982), there is a danger that substantial employer representation on corporate trustees may result in effective employer control of those boards, particularly if the employer representatives, or those directing their voting, are knowledgeable about superannuation matters. As outlined earlier in this article, that may result in the plans being run to suit employer objectives rather than being run impartially to optimise the benefits of all members. A better alternative is inviting independent experts on to those boards while still retaining employee control of the plan.

'The financial risk argument for employer representation on DBP trustee boards is virtually non-existent where the defined benefit is not guaranteed.'

Conclusion

There is no justification for mandatory employer representation on trustee boards of defined contribution plans. Thus any justification for employer representation would need to be based on DBPs.

It should be noted that the ASCPA (1991 p 2) and the union movement (Mercer, Campbell, Cook and Knight, 1991, p 2; Institute of Actuaries, 1992, p 1) do not recommend the use of DBPs.

The surplus argument for employer representation on DBP trustee boards would be substantially reduced by adopting an alternative concept of a surplus (which may be inevitable) and is undermined by the fact that employers are in a position to demand any special purpose financial reports they want in order to assess management of the DBPs they sponsor. They could also withdraw sponsorship if plans are not being well run. Thus there is no justification for mandatory employer representation on trustee boards, much less a 50 per cent representation.

The financial risk argument for employer representation on DBP trustee boards is virtually non-existent where the defined benefit is not guaranteed. Where that benefit is guaranteed by the employer, then again the employer will be in a position to demand relevant special

➢ purpose financial reports and to withdraw sponsorship if the plan is not being well managed.

Thus it seems that mandatory employer representation on superannuation trustee boards could be abolished or at least reduced to one representative or observer. That person could ensure that the employer is kept informed. The employer could then negotiate with employee representatives about any concerns that may arise. ❖

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Footnotes

1. This ignores policies about vesting.
2. This depends on the terms of the trust deed.
3. For a further comparison between the rights of superannuants and shareholders, see Scheiwe, 1996.

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LAW P

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Member choice and superannuation reporting

Dan Scheiwe

Abstract

The 1997 Federal Budget proposed that employers give employees the choice of five superannuation plans to which contributions can be credited. That choice means that more widespread reliance will be placed on reports and information promulgated by superannuation plans. Accordingly plan administrators need to be particularly careful that their promulgated reports and information are not only technically correct, but also are not misleading. Failure to do so means administrators and plans may be in breach of their common law and/or statutory duties. Various extant practices, such as reporting plan performance in terms of investment performance, are often technically correct but contrary to the theory of performance measurement and misleading. Accordingly, those practices frustrate attempts of various parties associated with superannuation to achieve their relevant objectives. This article suggests a more appropriate approach to reporting performance.

Until now, many superannuants have not had a choice of superannuation plan because membership of prescribed plans was a condition of their employment, or contributions under the superannuation guarantee legislation went to plans agreed to by relevant employers and unions. If superannuation plan choice is introduced (not just investment choice), superannuants and/or their advisers will need information on which to make the relevant decisions. Accordingly the information published by superannuation plans (for example brochures, reports, and financial information) takes on added significance. It becomes the basis for many more commercial decisions such, as joining or leaving a plan, and at least some of the reports and other information, usually distributed to members and/or others, may be deemed to be advertising. Superannuation plan administrators need, therefore, to be more careful than ever that the information they publish, irrespective of whether it is deemed to be advertising, is not only accurate, but is not misleading. Given that on average, superannuants are deemed not to be financially literate (Hubbard, 1982; Senate Select Committee, 1992), considerable care is needed to avoid issuing what may be deemed misleading information and therefore engaging in what may be deemed misleading conduct. ➢

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Do superannuation plan administrators have a duty to ensure that plan publications are not misleading?

➢ Superannuation plan administrators have both a common law and a statutory duty to ensure that their plans do not publish misleading information either in financial reports or elsewhere.

Common law duty not to mislead

Given the choice to be offered to superannuants, relevant published material may be seen as representations on which employees make their choice of fund. If superannuation plans publish misleading information, relevant contracts may be rescinded on the basis of misrepresentation, and possibly damages claimed if it is successfully argued that the misrepresentation was fraudulent (Vermeesch and Lindgren, 1978). Since fraudulent misrepresentation includes reckless misrepresentation (Vermeesch and Lindgren, 1978), superannuation plan administrators need to take cognisance of the assumed lack of financial literacy of many superannuants, in drafting their publications. In addition, information that is technically correct, may still be misleading. For example, while it is the view of the Australian accountancy profession that financial statements complying with applicable accounting standards give a true and fair view, or at least present financial information fairly (for example, Australian Auditing Standard No 702), the courts have not unequivocally shared that view. It is the courts' opinion that financial statements that comply with relevant accounting standards may still be misleading (Walker, 1986). That is, they may not give a true and fair view. This opinion also seems to be shared by the business community and legislators because under the former uniform Companies' Code, directors could ignore relevant approved accounting standards if they felt that compliance with them would result in financial statements that did not give a true and fair view. In addition, the comparable *Corporations Law* provision (s 323G) requires compliance with applicable accounting standards but permits additional information to be included in financial statements to ensure that a true and fair view is presented. That is, to overcome any perceived deficiency imposed by the applicable accounting standards. The superannuation industry has expressed similar views. For example, the Institute of Actuaries claimed that financial statements prepared under AAS 25 would 'mislead members' (Ryan, 1990) and a major firm in the industry claimed that they would 'cause confusion, misunderstanding and unnecessary concern ➢

EDITORIAL

This edition of the Journal contains an article by Dan Scheiwe on the important topic of whether the way in which trustees report earning rates to members of superannuation funds constitutes misleading or deceptive conduct.

That is an issue that is relevant to member choice of superannuation fund. The Federal Government has recently introduced the Bill to give effect to freedom of choice.

A significant change from the original proposal is that employers will be able to satisfy their choice obligations by offering unlimited choice to employees. Under this arrangement, the employer will not have to provide a list of funds for the employees to select from. Furthermore, the employees will be responsible for the collection of the key feature statement and application form that relates to the chosen fund or retirement savings account (RSA).

Where employers do decide to provide a list of funds and RSAs for employees to choose from, the minimum list that has to be provided has been reduced from 5 to 4. It will not be necessary for employers to offer an RSA of the institution receiving the employee's pay.

An alternative to the two arrangements referred to above will be that employers can negotiate a workplace agreement (which includes superannuation arrangements) with their employees. According to the Assistant Treasurer's statement of 25 November 1997, these agreements can be either formal or informal. The formal agreements are Australian workplace agreements and certified agreements. Informal agreements can take the form of an employee nominating in writing the fund/RSA of the employee's choice and the employer agreeing to that nomination. This, no doubt, will be a means adopted as an alternative to freedom of choice for employees to nominate the employer's fund or another fund or RSA to which contributions are to be paid.

These changes to the original announcement are a worthwhile development because they retain the integrity of freedom of choice for employees but, at the same time, make the obligations of employers less onerous. ◆

Noel Davis, General Editor.

among fund members' (National Mutual, 1990). In view of the above, it is noteworthy that the approved form of audit opinion for superannuation plans does not require an opinion on the truth and fairness of relevant financial reports (ISC circular IV.A.1), but rather, a less onerous opinion on whether the accounts are presented fairly (in accordance with applicable accounting standards).

Superannuation plan trustees also have a common law duty of honesty. Publishing information which a reasonable person ought to know has at least the potential to mislead is unlikely to be deemed an honest act.

Statutory duty not to mislead

The statutory provisions which are pertinent to the issuing of misleading information by superannuation plans are contained in the *Superannuation Industry (Supervision) Act* (SIS) and various other statutes.

The objective of Pt 18 of the SIS, as set out in s 143(1), is to prohibit false or misleading conduct. Accordingly, the effect of ss 144 and 145 is (inter alia) to make it an offence for any person to induce a person to become a member of a superannuation plan by false or misleading conduct. The maximum penalty for contravening s 145 is imprisonment for five years and provision is also made for civil liability under s 146. Section 147 prohibits trustees from engaging in conduct that is misleading or likely to mislead. Section 148 provides for civil damages for contravening s 147. Subdivision B of Div 3 of Pt 19 of SIS also prohibits the issue of false or misleading material by superannuation plans. Section 162 provides for civil liability and s 161 provides for criminal liability for relevant offences.

In addition, SIS has codified trustees' common law duty to act honestly.

Section 52 of the *Trade Practices Act* prohibits a corporation from engaging in false or misleading conduct. This provision is relevant to corporate trustees and corporate administrators.

Also at the federal level, the Corporations Law makes it an offence for corporate officers to participate in the issue of certain false or misleading information. In the context of this paper, this would apply to directors of corporate trustees and administrators, and corporate employers who distribute relevant information on behalf of superannuation plans which are corporations or unit trusts.

Each state of Australia has a *Fair Trading Act* which in part mirrors the above provisions of the *Trade Practices Act*. For example, in the *Fair Trading Act 1989* (Qld), ss 38, 40, 40A, and 45 replicate the provisions of the *Trade Practices Act* on false or misleading conduct. In addition, s 41 which mirrors s 53B of the *Trade Practices Act*, deals with misleading conduct in relation to employment. Thus employment advertisements which contain false or misleading information about superannuation (for example based on brochures published by funds) may also bring employers within the sanctions of a *Fair Trading Act*. For example, if employers advertise superannuation contributions as part of a salary package, and the benefit of those contributions is knowingly dissipated through cross subsidisation within the plan (Scheiwe, 1996b), then the employer may also be guilty of false or misleading conduct.

Does information currently published by Australian superannuation plans mislead?

It should be noted that not all of the above provisions require that conduct actually mislead. In some cases it is enough that the conduct have the potential to mislead.

Section 112 of SIS sets out the external reporting requirements for Australian superannuation plans. It simply requires an operating statement, statement of financial position and/or such other statements as required by the SIS regulations. Part 2 of the SIS regulations alone deals with plan reports to members, but implicitly it focuses on individual benefit statements, and trustees largely determine what other information is reported to members. Regulation 2.27 also requires that member reports refer to investment performance. This does not seem to be an onerous reporting requirement.

Controversial accounting standard AAS 25 (for example, Scheiwe, 1993; Robles and Tower, 1993; Klumpes, 1994; Ang et al 1997) embellishes on what should be reported to members in superannuation financial statements, but compliance with AAS 25 is not required by SIS. However, the Insurance and Superannuation Commission (ISC) does encourage compliance and many funds do comply (ISC circular IV.A.1). AAS 25 requires basic financial statements and recommends (but para 36 does not require) that trustees comment to members on investment performance.

SIS and AAS 25 are only part of the relevant reporting framework for superannuation funds. The accounting profession also expects its members to comply with generally accepted accounting principles (GAAP), the accounting conceptual framework (which includes Statement of Accounting Concepts # 2) and consensus views of the urgent issues group (Miscellaneous Professional Statement No 1). Statement of Accounting Concepts # 2 (SAC

➢ 2 — the objective of general purpose financial reports) states that general purpose financial statements should report on performance (which it defines as consisting of effectiveness, efficiency, and economy) in order that users of those reports can make decisions about the allocation of scarce resources, for example, where to place their superannuation investment. In SAC 2, the accounting profession acknowledges the need for both financial and non-financial information for the above purposes, especially for entities whose primary purpose is not profit maximisation. However, the accounting profession defers, if not absolves itself of, any responsibility for the production of non-financial information (SAC 2, para 30). Accordingly the above superannuation plan reporting requirements do not require proper reporting of performance in terms of effectiveness, efficiency, and economy. Therefore they do not place superannuants or their advisors in a position to make informed judgement about choice of plan. Various authors (for example, Welling (1992), Barker (1992), Arnold & Clarke (1996), Randall (1997)) are also critical of superannuation plan reporting. SIS and AAS 25 require only SOS reporting (same old stuff) even though it is widely accepted that the users of those reports are not financially literate. Not surprisingly, it is widely acknowledged that many superannuants don't understand the information they receive from their superannuation plans (for example, Welling, 1992; Buchan & Mullen, 1994; Quinlivan, 1994; Australian consumers' Council, 1994; Association of Superannuation Funds of Australia, 1995; Scheiwe, 1996) and therefore are not in a position to make the informed investment decisions that they will soon be offered.

While the above highlights the deficiency of extant superannuation reporting requirements, it does not prove that the external reports of Australian superannuation plans are misleading.

In many cases those external reports are misleading for the following reasons:

1. The reporting requirements emphasise investment performance of *plans* (return on investment, ROI), but not the rate of return actually derived by *members*. As a consequence it is likely that many superannuants will believe that the reported investment return is the return that they derive on their 'equity' in their superannuation plan.[1] That is not so for the following reasons:

(a) investment return (ROI) ignores all of the non-investment revenue and expenses of the plan including tax on non-investment revenue. Using this is as a measure of performance is like using a merchandising company's gross profit to measure its performance rather than its net profit. Thus it is a misleading to use investment performance as a measure of plan performance;

(b) AAS 25 does not even 'require' all investment costs to be offset against investment revenue. It only 'requires' that 'direct investment expenses' be offset against investment revenue (AAS 25, appendices); and

(c) The gross investment return earned by a superannuation plan may not be passed on to the members, especially in defined benefit plans and in those defined contribution plans that engage in reserving (Lockery, 1987). In some cases that difference is quite substantial. Table One below illustrates this in relation to an unnamed plan.

Column 2 above shows the after tax investment return reported by the plan from 1989 to 1996. Column 3 is the 'rate of interest credited on members' contributions' which were one third of the total contributions to the plan. Column 4 is the rate of interest credited on total before ➢

TABLE ONE

COMPARISON OF A SUPERANNUATION PLAN'S REPORTED ROI AND THE ROI DERIVED BY MEMBERS

Column 1 Year	Column 2 Reported ROI after tax %	Column 3 Rate of interest credited on member contributions %	Column 4 Rate of interest credited on total contributions %
1989	17.8	13	4.3
1990	0.5	13	4.3
1991	17.6	13	4.3
1992	2.3	10	3.3
1993	30.1	8	2.7
1994	-7.4	8	2.7
1995	16.7	5.97	1.89
1996	13.7	9.4	3.1
Average	11.4	10	3.3

tax contributions, and therefore is one third of Column 3. Based on information supplied by the plan involved, the author of this paper calculated the effective rate of return (that is, the internal rate of return) he had obtained on contributions (net of tax) made to the fund by him and his employer for the above period. It was 5.6 per cent. This figure, and those in column 4 above, clearly show that the rate of return derived by superannuants can be very different from the investment rate of return of the plan.

A second example is that of a person who is a member of several funds, including a public offer fund run by a large Australian insurance company. It recently advertised that moneys invested with it ten years previously would have doubled by the date of the advertisement. This of course requires only a cumulative ROI of 7 per cent. The company in question advertised a return of 9.9 per cent for the five years up to advertisement date. The member in question carefully calculated his return on contributions for the advertised ten years (that is, his full membership period) and arrived at a figure of 3.4 per cent. Only if he ignored the insurance company's up-front fees and ongoing fees could he get his ROI to approximate the advertised rate of return (bearing in mind that the insurance company reported its return for only the five most recent years). Over the ten years of his membership, his equity in the fund increased by $1600 (apart from his own contributions) and the insurance company charged him $2,400 in fees.

It is acknowledged (for example, ASFA, 1995) that a small difference in rate of return can make a substantial difference in the benefits derived by members and/or the contributions payable by plan sponsors (Angelo, 1991). Therefore to report superannuation plan investment rate of return and not equally emphasise the effective rate of return being derived by members, is quite misleading.

2. There is considerable controversy and diversity associated with the way investment return is calculated. This is acknowledged, for example, by the Australian Investment Managers' Association (AIMA, 1997), by ASFA (1992), and by Randall (1997). For example:

(a) Because most of Australia's superannuation plans comply with AAS 25, ROI is likely to be based on the operating statements which include unrealised gains, that is, gains that may never be realised or which may become losses if relevant markets suffer downturns. Most businesses cannot recognise unrealised gains, but if at all, account for them in accordance with AAS 10 or AASB 1010, that is, they are not recognised as income. Thus ROI for superannuation plans are not comparable with those of many other organisations. Because the superannuation industry is so secretive relative to the corporate sector, comparative 'performance' information is not as readily available to superannuants as it is to shareholders. Therefore, since one entity's performance can only be evaluated by comparison with the performance of other entities (for example, Wholey, 1993), superannuation investment performance is apt to be compared to other types of investments for which rates of return are readily available, for example, bank accounts, fixed deposits, debentures, bonds, etc. This is exactly what was done by one economic commentator (Black, 1995) who refuted on the basis of such comparisons, a former prime minister's claim that plan managers were 'donkeys and lemmings'. However, such comparisons are inappropriate because of the different accounting and taxation rules that apply. If the inappropriateness of such comparisons is not pointed out to users, then relevant reports are likely to be misleading.

In addition, plan administrators are likely to draw considerable attention to ROI in good performance years, but de-emphasise it in bad years, that is, those years where unrealised gains are reversed as a result of downturns in investment markets. In those years the dollar amount of the bottom line in the operating statement is apt to be emphasised, rather than rate of return on investment. That bottom line includes superannuation contributions as revenue. Most other entities report such contributions as capital added, which of course does not go through their profit and loss statement or operating statement. If the majority of a group of final year students in an accountancy degree think that the bottom line in a superannuation plan's operating statement is profit (Scheiwe, 1996), then it seems likely that many superannuants who are deemed to be even less financially literate would do likewise. That is they are likely to be misled into believing that the bottom line is profit. Interestingly, the accountancy profession is silent in the accounting standard on operating statements, about the interpretation that should be placed on the bottom line of an operating statement.

(b) Superannuation investment return is usually based on investment assets and

➢ ignores other types of assets and non-investment revenues and expenses. Thus it is an incomplete measure of performance, and therefore it is misleading to use it as the principal measure of superannuation plan performance.[2]

(c) How should investment return be calculated — on the basis of balance date investments, weighted average investments, simple average investments, or total assets? Barker (1992) highlighted superannuation industry concern about this issue. For example, Noble Sedgwick Lowndes publishes tables of investment performance figures which have numerous footnotes regarding how they are calculated. Since there is no uniform method of calculation prescribed, comparability of ROIs is questionable. Ferguson (1986) even argues that it cannot be measured at all!

3. Simple measures of investment return such as ROI must always be interpreted in light of the relevant investment risk (for example, Vaughan, 1990; Shields et al, 1992). While superannuation plans are required to have an investment policy, there is no requirement to measure and disclose investment risk, for example, by use of a Jensen or other indicator. In the absence of risk information, inherently ROI is misleading.

4. Much of the information currently reported by superannuation plans has the potential to mislead because it not understood by the members even though:

(i) AAS 25 (para 17) acknowledges that members are the primary users of their plan's financial reports;

(ii) the Australian Society of Certified Practising Accountants (1991) acknowledges the need for superannuation reports to be simpler and understood by the average person;

(iii) the Australian system for regulating the superannuation industry heavily relies on a well informed membership (Roberts and Larkin, 1994).

In the US, the *Employee Retirement Income Security Act* requires that superannuation reports be understandable by average members and the American Institute of Certified Practising Accountants (1993) recommends disclosures in 'plain English'. In NZ, Laswad and Baskerville (1995) acknowledge a similar problem. However, the World Bank and International Monetary fund acknowledge that a lack of simplicity and clarity is a problem in Australian superannuation (ASFA, 1995).

The above problems could be reduced by more non-financial reporting which would be necessary if performance were properly measured and reported, that is, if effectiveness, efficiency and economy were reported on. Purporting to report on the performance of a superannuation plan by measuring and reporting only its investment performance is misleading, yet many authors implicitly equate superannuation performance with ROI (for example, Coutts, 1984; Ferguson, 1986; Angelo, 1991; Shields et al, 1992; Black, 1995; Johnson & Savage, 1995; Blake et al, 1997). This is like trying to report on the performance of a conglomerate by reporting on some aspects of only one of its segments. It is contrary to the literature on performance measurement.

The relevant literature abounds with acknowledgments of the folly in measuring performance on the basis of one (financial) measure (for example, Curtis, 1985; Eccles, 1991; Jahera & Lloyd, 1992), and also abounds in support from various disciplines, for the use of multiple (non-financial) performance measures (for example, National Association of Accountants, 1981; Williams, 1986; Shanahan, 1989; Miah, 1991; Esser, 1993; Chartered Institute of Management Accountants, 1993). There is also widespread support for measuring performance in terms of effectiveness and efficiency (for example, Parker, 1990; Miah, 1991) and some support for including economy (for example, Esser, 1993), productivity (Ammons, 1995), or adaptability (Bhargava, Dubelaar & Ramaswami, 1994). Since it is not the purpose of this article to review the literature on performance measurement, the following points will be made briefly as a prelude to the next section of this article.

- There is more than one appropriate set of performance measures for any organisation (for example, Venkatraman & Ramanujam, 1987; McMann & Nanni, 1994).
- 'As yet there are no clear cut answers or pre-determined processes for managers who wish to change their measurement systems' (for example, Keats, 1990; Eccles & Pyburn, 1992).
- Performance measurement systems should be kept simple and allowed to evolve. Organisations are unlikely to select the most appropriate set of performance measures the first time, and the set should change as the organisation changes (for example, Romano, 1989; Eccles & Pyburn, 1992, Singleton-Green, 1993).
- The evolution of a performance measurement system is extremely difficult and requires a good deal of judgment (for example, ➢

National Association of Accountants, 1981)

- What are appropriate measures depends on what is being measured (for example, Bhargava et al. 1994)
- Performance measures take many forms (for example, Lookatch, 1991)

Just as inter-firm comparisons are encouraged for financial performance measures, so too Eccles & Pyburn (1992) advocate inter-firm comparisons for non-financial performance measures. This implies bench marking which in turn suggests co-operation between organisations engaged in similar activities to reach agreement on measures and accounting methods. Whatever set of performance measures is used, Provost & Leddick (1993) suggest that objectives or stakeholders be used as a guide to their selection. This is consistent with the objectives of financial information: to provide information useful to users (of reports) in making and evaluating decisions on the allocation of scarce resources (SAC 2). Diligent plan managers might even ask the members what information they want reported! (Anderson & Epstein, 1995)

In an effort to make a positive contribution to the issue of performance reporting by superannuation plans, Table Two below sets out some possible superannuation plan performance measures classified under effectiveness, efficiency, and economy. Table Two is not prescriptive, but rather it illustrates what might be used as a starting point to develop a relevant performance reporting framework.

While extant use of investment performance implies using a single performance measure (ROI), Table Two, like performance measurement theory, implies that multiple performance measures should be used. A disadvantage of the latter approach is that it does not provide a sumative evaluation for those who want one. This could be overcome by combining the multiple performance measures into a sumative measure by use of data envelope analysis or exploratory data analysis (for example, Bhargava et al. 1994).

In conclusion on this point, it should be noted that non-financial performance measures also have deficiencies, including some of those afflicting financial measures (for example, Du Pont-Morales

TABLE TWO

POSSIBLE PERFORMANCE MEASURES FOR SUPERANNUATION PLANS

Effectiveness	(A measure of the extent to which objectives have been achieved.) AAS 25 (para. 10) defines a superannuation plan as *an arrangement whereby it is agreed between trustees and employers, employees or self employed persons, that benefits be provided upon the retirement, death, disablement, or other specified events.*
1	Comparison of each of death, disability and retirement benefits with those of the top 5 or 10 plans (in terms of those benefits)
2	Results of surveys of member satisfaction with their benefits
3	Member satisfaction with the security of their benefits
4	Member satisfaction with options under their plan (including ability to change to a plan operated by a totally different entity
5	The number of complaints lodged with the plan and the number referred to the superannuation complaints tribunal or to a court
Efficiency	(A measure of inputs relative to outputs generated by them)
1	Common form financial statements and comparisons of each of the major expense categories with the 5 or 10 best performing plans (on the basis of that criteria)
2	The average lag in receipt of employer contributions and the average lag in investing all contributions
Economy	(A measure of whether assets were obtained on a timely basis at the best possible price)
1	Details of large investments whose ROI is lower than 95% of the plan's average investment return
2	Investment performance (ROI, ROA, and effective return on each member's benefit statement)
3	Disclosure of the amount of fringe benefits tax paid each year
4	Details of trustee and senior executive's emoluments and travel
5	A Jensen or similar indicator

➢ & Harris, 1994) and are not a panacea. However, they are likely to be a substantial improvement on the present unsatisfactory reporting practices and may be a way of avoiding liability for misleading conduct or issuing misleading information.

Implications for the superannuation industry

This paper has raised the issue of misleading reporting by superannuation plans without use of creative accounting (for example, see Thomas, 1983; Slater, 1987; Lusk, 1992; Brown, 1992). This has important implications for most parties associated with Australian superannuation.

From the members' perspective, rendering incomplete and/or misleading information means that superannuants don't know whether they are deriving optimal benefits and whether superannuation is achieving their objectives.

From the perspective of superannuation administrators, issuing misleading or potentially misleading information may render them liable for prosecution and damages. Incomplete information may also constitute (potentially) misleading information.

From the superannuation industry's perspective, litigation of the type foreshadowed above will bring the industry into disrepute and create pressure to remove the compulsion for employees to contribute to any superannuation plan under the superannuation guarantee legislation or under conditions of employment. Sub-optimal performance resulting from an uncompetitive environment will generate the same outcome. Thus the industry itself will also lose. Optimal performance will not be achieved without a high standard of reporting and a competitive market. Extant practices do not achieve the objective of external reporting.

A former Federal Treasurer said (Dawkins,1992, p 18):

> One of the Government's central objectives — of strengthening prudential supervision — reflects another key policy challenge: that of ensuring the retirement income market operates both efficiently and securely to maximise, subject to risk, the level of superannuation benefits produced from given contributions inflows.

Given the seriousness of the aging population problem in Australia, it is unlikely that the present Federal Government would disagree with that objective. Therefore, from the national perspective, if the lack of appropriate reporting and the absence of full consumer sovereignty mean that the superannuation industry is unlikely to perform as well as it would if plans were subject to normal competitive pressures, then the Federal Government will not achieve an important national objective, and will still face indefinitely, substantial costs for pensions for the elderly.

Clearly the extant reporting requirements for superannuation plans are inadequate and major institutional arrangements are being placed in jeopardy as a result. The recent Federal Budget may provide the impetus to improve both. ✣

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Footnotes

1. The legal position is that while the trustee of a trust has legal title to the assets of the trust, beneficiaries have an equitable interest in them, that is, they are the equitable owners of the trust's assets. Most superannuation plans are trusts (Quinlivan, 1994). AAS 25 requires members' accrued benefits to be disclosed as a liability in superannuation plan financial statements, thus implying that beneficiaries are not the owners of their superannuation plan's assets.

2. Superannuation accounting pronouncements in the UK and US, and international accounting standard IAS 26 do not require the measurement or reporting of changes in the market value of non-investment assets.

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Are funded defined benefit superannuation plans fundamentally a fraud?

Dan Scheiwe

A funded defined benefit superannuation plan (FDBP) is a superannuation plan in which members' retirement benefits are calculated by a formula set out in the relevant trust deed, and in which benefits are funded from a pool of assets held by the plan's trustees.

Different answers to the question posed in the title are possible. This article presents the affirmative argument that FDBPs are fundamentally a fraud. That argument is based on the assertion that cross-subsidisation occurs within FDBPs because the employers effectively control the plans rather than the trustees. How does this occur?

Cross-subsidisation

Employing managers arrange for the employer sponsoring the FDBP to contribute say $1 to the plan to provide superannuation benefits for Employee A. However, in the vast majority of cases, Employee A does not receive the full benefit of that $1. Some of the benefit is used to fund higher benefits for Employee B for whom the employer has also contributed $1. This constitutes cross-subsidisation. How does that cross-subsidisation occur?

In defined benefit plans, the superannuation benefit is calculated in accordance with the following formula:

SB = YRS x FAS x BR

Where **SB** is superannuation benefit, **YRS** is years of plan membership, **FAS** is the final average salary for the last three years of membership and **BR** is a benefit ration which, in simple terms, indicates the annual rate of return on annual contributions to the plan.

Once that formula is set out in the superannuation plan's trust deed, BR is 'fixed' and so the size of the benefit that each member derives from the plan can be varied by adjusting YRS and/or FAS.

YRS can be used for cross-subsidisation if, on resignation, the employee cannot roll over both the employee contributions and all of the employer contributions made to the plan on his or her behalf (plus a reasonable return on same). Any such loss of contributions or reasonable return on contributions by Employee A on resignation, would stay in the plan and would fund or constitute cross-subsidisation of B's benefits if B stays in the plan. In addition, voluntary early retirement schemes can involve cross-subsidisation via the principle described in the next section of this article.

The employee can control YRS by resignation and the employer can control YRS by dismissal. However, other checks and balances may be in place to reduce the scope for cross-subsidisation resulting from varying YRS. For example, it is now more common for employees to be able to roll over all of their own contributions and at least some of their employers' contributions (plus earnings) to another superannuation fund or an approved deposit fund if they resign. In addition, unfair dismissal laws may reduce management's scope to manipulate superannuation benefits by controlling YRS.

The above cross-subsidisation may well be exacerbated by the employing manager's ability to control FAS. If the rates of salary increase for the vast majority of staff are relatively modest, then 'surpluses' will become available to fund superior benefits for the minority of staff whose salaries increase relatively faster, particular in the last few years of employment. Thus, by controlling FAS, effectively it is employing managers who have overall control of the FDBP, not the trustees. The trustees simply control the day-to-day administration of the plan. To put it another way, the trustees are responsible for making and baking the cake, but the employing managers decide on the recipe and control the distribution of the cake. As one would expect, on the basis of fundamental economic and accounting theory (which in ➢

turn is based on the theory of human nature), employing managers exercise that control in their own interest by arranging for superior benefits from the plan themselves. That is, they arrange for major cross-subsidisation.

How is that done? It is done in two ways. First, it is the employment managers who have the knowledge which enables them to see the benefit, to themselves, of having a FDBP and so influence the decision to opt for or retain a FDBP, rather than opting for an alternative type of scheme. Second, it is the employing managers who are best placed to determine plan members' FAS (this includes their own FAS). Plan members whose salaries increase rapidly just prior to the last three years of plan membership derive proportionately more SB, relative to contributions, than members whose salaries did not increase or increased only slightly. Thus, employing managers can manipulate the SB they derive by arranging for significantly increased FAS for themselves, especially under enterprise bargaining. The relatively more generous benefits that the employing managers derive can only be obtained from a FDBP if other members derive sub-optimal benefits and cross-subsidisation occurs.

Where is the fraud?

The first fraud is on the proprietors of the employing entity (that is, the shareholders in the case of a company and taxpayers in the case of a government or semi-government entity). Presumably, they have agreed to contribute $1 for superannuation benefits because A is an employee. This implies that the benefit of the $1 is intended for A. If that is not the case, the employer could agree to contribute less than $1 because A was employed (that is, less than $1 for A's benefit) and more than $1 because B is employed (that is, more than $1 for B's benefit). That is not done. Thus, it can be concluded that the proprietors did not agree that some of the benefit of the $1 contributed because A is employed, should be diverted to the benefit of B. Thus a fraud has occurred on the proprietors sponsoring the plan. One school of thought 'justifies' this practice in terms of superannuation philosophy, namely that benefits should seek to maintain superannuants' post-retirement lifestyle at their pre-retirement level.

The second fraud arises because it is virtually impossible for the trustees of FDBPs (which are usually trusts) to fulfil their statutory and common law duties. Trustees have both a common law and a statutory duty to manage the trust's affairs impartially, that is, in the best interest of all members. In FDBPs that does not occur for two reasons:

1. As explained above, the trustees do not really control the plan. They control only the subordinate tasks associated with running the plan. The employing managers effectively control the plan by controlling FAS. Thus, trustees cannot perform a major part of their responsibility.
2. Since FDBPs provide superior benefits to some members at the expense of other members via cross-subsidisation within the trust, all members are not being treated equally, that is, the plan is not being run impartially. Therefore, because of the nature of an FDBP, trustees cannot fulfil their common law and statutory duty of impartiality.

For these two reasons, FDBPs are fundamentally a fraud on both the members and the sponsoring proprietors, who assume that trustees impartially manage the trust for the benefit of all the members.

The third fraud is on the majority of members of the FDBP. This arises because of the nature of both employer and employee contributions to superannuation plans. They are part of the employee's remuneration. No superannuation contributions are gratuitous bequests on the employee by the employer. They are part of the employee's remuneration. Therefore, if any c those contributions, or the income derived by the plan by using those contributions, are diverted away from Employee A to cross-subsidise the superior benefits of Employee B, then it constitutes a breach of trust. Continued failure by trustees to point this out to members constitutes a fraud on members by the trustees.

Implications

In conclusion, it seems that it is only a matter of time before litigation occurs to test the above assertions. If that litigation is successful, then it will have a profound effect on the superannuation industry. The cases that lay some of the foundations for that litigation, and the change in social and judicial opinion that also provide the necessary basis, have already occurred (for example, striking down harsh and unconscionable contracts, protecting persons in unequal bargaining positions due to ignorance of relevant financial matters and ensuring equal opportunity). Accordingly, trustees of FDBPs would be well advised to review their present arrangements. ✣

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Superannuation: negligence and the employer sponsor.

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Superannuation: negligence and the employer sponsor.

Abstract

Many Australian superannuation fund trustees enjoy the protection of the veil of incorporation and no trustees are liable for fund performance, provided they abide by the Superannuation Industry Supervision Act and their fund's trust deed. However, many employers require their employees to be members of a particular fund as a condition of employment. If, as a result of being a member of the employer-specified fund, an employee suffers economic loss, relevant fund trustees are protected from legal action, but there is no statutory protection for employers who forced relevant employees into funds they specified. Accordingly, it appears that employers may be liable for economic losses suffered by relevant employee-members provided it can be shown that such losses resulted from the employer's failure to take reasonable care in the choice and/or monitoring of the particular fund. In many cases such losses are reasonably foreseeable because they are the result of (a) protracted poor management by trustees (half of whom are likely to be employer appointees/representatives), and/or (b) misleading and inequitable superannuation arrangements.

Superannuation: negligence and the employer sponsor .

1.0 Introduction

In Australia, the federal government requires most employees to be in some form of superannuation, and consequently many employers force their employees to be in superannuation funds which they specify either alone or in collaboration with relevant unions. Thus normal market conditions are not able to function with the result that many superannuants are suffering economic losses ie. deriving sub-optimal superannuation benefits. Therefore it follows that employers may be liable for economic losses of employees resulting from the employer's negligent choice of fund and/or failure to monitor fund management and performance. Had the employees been at liberty to choose which fund they joined, then the employer's liability would not have arisen.

Given that some 91% of Australian employees are covered by superannuation (APRA web page, March 1999), the potential for litigation is very substantial, as Table 1 below confirms. That table provides details of the size, membership and distribution of superannuation funds in Australia.

Table 1

Type of plan	Members	Members	Funds	Funds	Assets	Assets
	'000	%	#	%	$' billion	%
Corporate	1341	7	3463	2	68	18
Industry	5910	30	101	0	28	7
Retail	9003	46	249	0	107	28
Excluded	358	2	182589	98	50	13
Total private sector	**16612**	**85**	**186402**	**100**	**253**	**65**
Public sector	2877	15	41	0	85	22
Annuities, life office reserves, etc	Na	na	na	na	49	13
Total	**19489**	**100**	**186443**	**100**	**387**	**100**

Source: APRA web page. March 1999

Since Australian superannuation funds had assets of $387 billion in March 1999, if only a 1% economic loss were suffered by all fund members, then there would be an annual claim of $3.87 billion. As is shown later in this paper, in many cases the relevant percentage loss by superannuants is much higher. In view of the size of Australia's superannuation industry, it is quite feasible that other financial institutions will also perform sub-optimally because they face less competition from the superannuation industry.

Even though the federal government continues to require Australian employees to contribute to superannuation, it has failed to ensure that the industry operates optimally either by direct action or by empowering superannuation fund members (Scheiwe, 1996). In addition, there appears to be no evidence that relevant employers are acting to optimise the benefits that their employees derive from the superannuation funds they specified. In many cases the opposite appears to be true because employers are more concerned to ensure that they do not have to top up relevant defined benefit funds, with the result that employees derive sub-optimal superannuation benefits. Another reason that employers ensure that in some funds, most employees derive sub-optimal benefits, is that such arrangements fund far superior benefits for senior management because they control employee salary levels, which in turn determine the superannuation benefits of the selected employees (Scheiwe, 1996). Thus employers selectively reward some employees at no additional cost to their firm.

Because so many employees will derive sub-optimal retirement benefits, the federal government's retirement incomes policy will fail since the majority of retired employees will be forced to rely on aged pensions to a considerable extent. Thus 91 % employee superannuation coverage does not mean that 91% of retirees will have adequate retirement incomes without an aged pension.

Table 2 below shows the proportion of non-excluded superannuation funds in each of three categories: defined contribution, defined benefit, and hybrid. It therefore shows that

26% (14% DBP and 12% Hybrid) of Australian superannuants may be adversely affected by the negative aspects of defined benefit plans referred to above ie. 2,903,000 superannuants .

Table 2

Jun-99

Non-excluded superannuation funds in Australia

	Type of Fund					Membership ' 000				
Sector	DCP	DBP	Hybrid *	Total	%	DCP	DBP	Hybrid *		%
Public	32	16	30	78	2	722	214	1872	2808	15
Private	2683	520	431	3634	98	15740	196	621	16557	85
Total	2715	536	461	3712		16462	410	2493	19365	
%	74	14	12		100	85	2	13		100

* Partly DCP & Partly DBP

Source: APRA web page

How can such an unsatisfactory situation arise and be sustained?

On the one hand, the superannuation industry claims that the covenants and operating standards incorporated into the Superannuation Industry Supervision Act (1993) ensure that members' superannuation investments are well protected.

However, on the other hand, an analysis of the relevant legislation reveals that many of the provisions setting out these key safeguards are quite ineffective (Scheiwe, 1999a). Consequently, those people who invest in superannuation are in a far more vulnerable position than those people who invest in Australian corporations (Scheiwe, 1999b). In view of the ineffectiveness of the legislation, it is not surprising that successive regulators of Australian superannuation have a very poor record of enforcement (see ISC annual reports). Thus, it has been claimed that Australia's superannuation regulatory system is the product of regulatory capture by the industry (eg. Taylor and Little, 1993). Consequently superannuants have far less rights than shareholders and therefore have far

less financial protection (Scheiwe, 1999a).

These factors, together with the employee's greater awareness of their civil rights and solicitors' willingness to launch speculative actions with contingency fees (no win/no fee) means that Australian superannuation is likely to see litigation for the recovery of economic losses sustained by fund members.

1.1 Australia's present superannuation regime

For many years Australian superannuation was "regulated" by a few provisions of the Income Tax Assessment Act and the trust/trustee acts of the states. This state legislation applied because some 94% of superannuation funds are trusts (Quinlivan, 1994). However, state trust/trustee acts are quite inappropriate for superannuation funds (ALRC, 1992) eg. because of:

(a) the rule against perpetuities

(b) they did not envisage large numbers of members

(c) they were mainly written with deceased estates in mind

In 1987 the federal Labor government introduced the Occupational Superannuation Standards Act (OSSA) and the Insurance and Superannuation Commission (ISC) became the superannuation industry regulator. However, it was soon claimed that OSSA was deficient in that the only action that the ISC could take regarding delinquent trustees, was to withdraw tax concessions to their fund, thus penalising innocent members. Accordingly the Superannuation Industry Supervision Act (SIS) replaced OSSA in 1993. SIS has been amended numerous times since then. For example on 1.7.1998, the Australian Prudential Regulation Authority (APRA) replaced the ISC. At the same time, responsibility for excluded superannuation funds (sic, those with less than 5 members) was given to the Australian Taxation Office (ATO), while reporting and consumer protection responsibilities were given to (the new) Australian Securities and Investments Commission (ASIC). APRA was also given responsibility for the wider prudential

supervision of various deposit taking institutions which were previously regulated by state legislation eg. building societies and friendly societies. Therefore the regulation of Australian superannuation funds is currently shared by three agencies which also have onerous regulatory responsibilities. This is hardly a satisfactory situation.

When it effectively introduced compulsory superannuation (in the form of superannuation guarantee legislation), the Australian federal government was not going to be directly involved in the superannuation regime it introduced (eg. by operating a federal government superannuation scheme). As can be seen from Table 2, the federal government has allowed the private sector to operate 98% of Australian superannuation plans. These were mainly corporate funds set up under industrial awards, or retail (ie. public offer) funds (see Table 1). This approach avoided undermining existing superannuation providers and minimised the federal government's cost of implementing its retirement incomes policy.

SIS has placed heavy reliance on plan trustee compliance, auditor whistle blowing, and member monitoring of their plans. This explains the ISC statement that an informed membership is a central plank in the regulation of Australian superannuation industry and that the relevant regulatory system is "market oriented" (Brown et al, 1994).

Even though the ISC used to undertake some plan reviews to check on whether the prudential safeguards in the relevant legislation were being followed, the number was so small that the ISC conceded that member monitoring is critical to ensuring that plans are properly run. APRA appears to be of the same view.

Unfortunately the relevant legislation does not put superannuation plan members in a position from which they can ensure that their plans are properly run (Scheiwe, 1999c). Hence the Australian system for regulating the superannuation industry is fundamentally and serious flawed in that:

- on the one hand, superannuants are not provided with information which allows them to decide if their plans are well run, and do not have the power to rectify the situation if they are dissatisfied. Not surprisingly, Ambrovich (1994) claims that there is a burgeoning of dissatisfaction with superannuation benefits and entitlements.
- on the other hand, superannuants are not given the statutory protection that their vulnerability deserves. This vulnerability is exacerbated by the fact that The Superannuation Complaints Tribunal always had very limited powers by virtue of s.14 of the Superannuation (Resolution of Complaints) Act, and even these were ruled unconstitutional in Wilkinson v Clerical Administrative and Related Employees Superannuation Fund Pty. Ltd., 1998.

1.2 Proposed choice of fund legislation

The current Australian Treasurer identified the following government objectives for Australia's financial system (Costello, 1997):

- increase competition
- improve efficiency
- preserve integrity

Clearly the government was concerned about superannuation fund performance. Accordingly, the Howard government sought to introduce choice of fund legislation in 1998 and in 1999 (Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill, 1998). Under the proposal employers were to give employees either limited choice of fund or unlimited choice of fund. Which option was chosen was a decision for each employer.

Limited choice of fund option meant allowing employees to choose a fund from at least four nominated by the employer, being at least one from each of four categories below:

- at least one public offer fund
- at least one retirement savings account (RSA)
- a standard employer fund to which the employer contributes or a relevant public

sector fund

- at least one relevant industry fund

The limited choice of fund model did not include private (ie. DIY) funds.

The unlimited choice of fund model meant that employees could chose any fund they wished and the employer would forward superannuation contributions to it. Most (large) employers pay employees by electronic funds transfer to individual bank accounts in order to minimise relevant costs. Thus it seems that the same facility would be equally effective for superannuation, unless the employer was gaining some other advantage from restricting choice of fund.

The superannuation industry lobbied vigorously against the proposed legislation, and many funds introduced choice of investment (within the one existing fund) to undermine the argument for choice of fund. Basically three choices are given by relevant funds . These are summarised in the following table.

Common names	Assets	Risk	Possible Return
Capital guaranteed	Mostly cash and fixed deposits	Low	Lowest
Balanced	Limited cash and fixed deposits, property, equities	Medium	Medium
Capital growth or market linked	Mostly shares and other equities	Highest	Highest

Unfortunately the above bill was not passed by the federal parliament and so many Australian superannuants continue to suffer economic losses as a result of being forced into superannuation funds that they did not choose.

2.0 Economic loss suffered by employees

It has been asserted in this paper that many members are deriving sub-optimal returns from their superannuation funds. Some explanation of how that occurs has already been

given above, but the assertion is further supported by the Australian Society of Certified Practising Accountants (1991) and by Ambrovich (1994). Table 3 below also supports that view. It compares the investment returns of 6 categories of superannuation plans and 10 categories of investment funds (various investment strategies in each case) operated by the same large financial institution in Australia. Clearly the average return for the superannuation funds is much lower than for the investment funds.

Table 3

Comparison of super fund and investment fund returns
(7 year ROR to 1.7.1998)

	Super 6 plans %	Invest 10 pools %
	9.32	15.67
	9.23	14.84
	9.29	12.54
	9.33	9.9
	4.94	22.63
	3.25	10.6
	8.69	21.87
	7.98	23.11
	4.84	6.16
	8.73	27.12
	7.96	16.61
	4.7	1.99
		10.79
		10.59
		5.81
		5.48
Average	7.36	13.48

Source
BT Investors Circle, Winter 1998

In the context of this paper, "superannuant" means a member of a superannuation fund, and "economic loss" means that the superannuant derived a lower increase in retirement benefits as a result of the operation of his/her mandatory fund than s/he could have derived as a member of a fund that s/he would have chosen if allowed choice of fund. Thus an economic loss is different from an accounting loss in that an accounting loss would mean lower benefits at the end of the relevant period than at the beginning of

same. Economic loss simply means that the member could have derived a higher accumulated benefit at the end of the relevant period (after allowing for contributions) than was actually the case.

Anyone can be wise in hindsight, and so many economic losses can be regarded as simply a normal risk involved in business and investing. However, this paper is not concerned with those economic losses. It is concerned with economic losses which can be reasonably anticipated and therefore reasonably avoided.

How can such economic losses be incurred by superannuation fund members? Broadly there are three categories of ways:

(a) sub-optimal investment strategies (and hence investment returns)

(b) failure to pass on investment income to members equitably

(c) a lack of control over fund operating costs

Each of these is discussed below.

Category (a)

The following are examples of sub-optimal investment strategies:

(i) an overly cautious investment strategy (eg. an unusually high proportion of investment assets in cash and fixed deposits, rather than adopting a more balanced or aggressive investment strategy). Such a strategy may be justified where the vast majority of members are near retirement, but is not justifiable for a "normal" fund that is not in an advanced stage of decline. A highly liquid investment strategy may be adopted by such a fund if the trustees are not diligent enough to manage the investments themselves or not diligent enough to engage experts who can manage the fund's investments properly.

The performance of the Tertiary Education Superannuation Scheme (TESS) may illustrate this point. Quite remarkably, TESS's performance improved in 1997 when it was faced with public criticism and the prospect that new member choice legislation may

allow TESS members to transfer to a new competitor . In 1997, TESS reported a return of 21%. For the years 1990 to 1996 it reported the following returns (before deducting operating costs): 14.9%, 14.2%, 9.4%, 7.6%, 5.6%, 5.4%, 7.6%. TESS's performance did not rate well in comparison with other industry funds and its dramatic turn-around in 1997 was not typical of the industry. The dramatic change in returns was due to an equally dramatic increase in reported change in market value of investments. One trustee claimed that the fund had previously been (sic) "locked into bad investments".

Overly conservative investment strategies in any superannuation fund need not be the result of a lack of diligence on the part of trustees. They may also be the result of not investing at arm's length. For example, investing so as to obtain a directorship for an influential trustee (and hence personal gain), rather than investing so as to optimise investment return for the superannuation fund and its members. Another example may involve investments brokered by relevant trustees to earn commissions for particular unions.

(ii) an overly optimistic investment strategy may also produce sub-optimal, if not disastrous results. While SIS (s.52) contains a covenant which requires trustees to formulate and give effect to an investment strategy which takes cognizance of risk, return, and liquidity, APRA is powerless to take action unless it is obvious that more enforceable SIS provisions have been breached eg.

- breaching the sole purpose test (s.62), as illustrated by cases where the trustees were using the fund's assets to finance their own businesses or pleasure activities in contravention of the in-house asset rule which is set out in s.69 (eg. Gray and Dorkins, 1996), or
- breaching provisions of the fund's trust deed (eg. Gallery and Sharples, 1994).

Category (b)

The following are examples of fund policies that do not result in an equitable distribution of fund income:

(i) excessive reserving of fund income in defined contribution (aka. accumulation) funds. Trustees have a statutory right to maintain reserves (SIS s.115). If properly used, reserves allow fund administrators to even out benefits between times of economic boom and economic downturn. However, there is no statutory control over the level of such reserves, though the ALRC (1992) has stated that reserves up to 20% of accumulated benefits are acceptable. Consequently reserving was so misused in conjunction with vesting provisions in trust deeds, that some funds were referred to as "tontine" or "cherry picker schemes" (Batroney, 1991). In such schemes, large reserves were established and the scheme was wound down in various ways (eg retrenchments, transfer of members to other intra group companies etc) until only a select few members were left and then the entire reserve was shared between the remaining few.

(ii) long vesting schedules. Vesting refers to whether the employer's contribution to the superannuation fund has been allocated to the members, and can therefore be "taken" with the members when they leave that particular fund. Long vesting schedules meant that employees had to be in the employ of contributing employers for many years before they could take (any of) the employers contributions with them if they left that employer. As a result of voluntary and involuntary staff turnover, funds accumulated far more employer contributions than had been contributed on behalf of remaining members. Hence the fund could afford to pay very generous benefits to those who remained (or were allowed to remain) in the fund. The benefit protection provisions in SIS regulations (viz. SISR Part 5) require vesting of mandated employer and all employee contributions but does not make adequate provision for the vesting of non-mandated contributions or fund income and allow cross subsidisation within DBPs (Scheiwe, 1999b). Consequently the superannuation abuses outlined above still continue

(iii) overly conservative actuarial assumptions in defined benefit plans and hence overly conservative defined benefit formulae. These ensure that those people with high salary increases near the end of their membership of funded defined benefit funds will derive superior returns as compared most members of the fund.

In addition, manipulation of actuarial assumptions has been used to artificially inflate

surpluses which have then been repatriated to employers (Benedict, 1991). The superannuation spokesman for the Australian Institute of Chartered Accountants referred to that practice as "legalised robbery" (Brown, 1992). Surpluses can still be repatriated under SIS (s. 117).

Category (c)

In this paper, "operating costs" of funds includes trustee remuneration and premiums paid for life and/or disability insurance. There is no control over the operating costs of Australian superannuation funds because effectively the trustees are not accountable to anyone. This is so because there is no statutory requirement for Australian superannuation funds to have (annual) general meetings at which members (like shareholders):

- elect trustees
- appoint the auditor
- have the auditor report to them
- approve audited financial statements (which were automatically sent to members)
- set trustee remuneration
- express opinions on fund policy
- etc.

In addition, the accounting standard for superannuation (AAS 25) caused so much tension between the superannuation industry and the accounting profession (Klumpes, 1994) that there is no statutory backing for **any** accounting standard relevant to superannuation. Hence there is no statutory requirement to report related party transactions, even though SIS requires investment transactions to be conducted at arm's length (s.109).

The above aspects of the Australian superannuation regulation stand in stark contrast to the provisions relating to companies (which can be regarded as an alternative type of investment vehicle). Thus one should be concerned that if shareholders suffered the abuses of the 1980s despite better rights and hence regulatory protection, then

superannuants must be vulnerable to at least similar losses.

4.2 Are the above problems wide spread?

The authors are not aware of any comprehensive study of the absolute performance of Australian superannuation funds. However, the following points can be made:

(i) it is widely acknowledged that most fund managers don't beat relevant indices

(ii) anecdotal evidence strongly suggests that many superannuation fund members are deriving sub-optimal returns. This is masked by the fact that funds are encouraged to report investment returns and these may be very different from the return derived by members because investment return ignores fund operating costs and fees imposed on members, and also ignores cross subsidisation and reserving as described above. While crediting rates must be reported in member benefit statements, they may also ignore various charges imposed on fund members, and so create a false impression of the rate of return derived by members.

5.0 What statutory protection is currently available to members?

As in section four of this paper, this discussion will use the three categories of ways that superannuation fund members can suffer economic loss.

5.1 Category (a) inappropriate investment strategy

The benefit protection standards are silent regarding overly conservative investment plans which result in sub-optimal benefits. SIS s.52(2)f requires trustees to "formulate and give effect to an investment strategy that has regard to (sic) risk, diversification, liquidity, and fund liabilities. This provision has been applied in conjunction with the sole purpose test (SIS s.62) to protect superannuants eg. from:

(a) unscrupulous employers who seek to use the funds as (i) a personal source of finance for their businesses (despite the restriction on in-house assets) or (ii) for their pleasure (Lavelle, 1995).

(b) honest but bad investment management of superannuation funds eg. the case the trustee of an excluded fund who had a penchant for playing the stock market, much to the detriment of the fund's assets, and in another case where the trustees invested in only two

areas, one of which did not appreciate and one of which was badly affected by the Asian financial crisis in the second half of the 1990s (Griffith, 1998). The fund reported a –43% return for 1998. In both cases the trustees did not diversify the investments because they thought they could generate superior returns from specialised investments.

Overly optimistic investment strategies can have an even worse long term result than overly conservative policies. While each fund's investment strategy must be reported to members, this can be done in such a way that members who do not undertake a detailed analysis of their fund (ie. the vast majority) can be lulled into a false sense of satisfaction. This is illustrated by considering the national superannuation scheme for Australian university staff. This is called Superannuation Scheme for Australian Universities (SSAU). The trustees have emphasised in recent annual reports that the fund's investment return in the top quartile, and have even promulgated a glowing report on the fund which was published in "Superfunds", the magazine of the Association of Superannuation Funds of Australia. In contrast, trustees did not promulgate the views of Darly Dixon, an Australian financial adviser and well known and respected commentator on superannuation. He described this fund on ABC radio as "a national disgrace" and "Australia's biggest slush fund". He was also critical of the fund in an article in The Bulletin (Dixon, 1999). Table 4 below shows that SSAU's above average investment returns were due to a major change in investment strategy which made it far riskier than previously, and far riskier than most Australian superannuation funds. Like the Dixon article, this point was not emphasised in SSAU's annual reports to members.

Table 4

(see separate page)

The table above shows that:

- the proportion of SSAU's investment assets which were allocated to equities (Australian and overseas) rose from 40% in 1988 to 75.4% in 1998

- SSAU's asset allocation was significantly different from the national average allocation in 1994, 1996, and 1998. It may also have been different in other years as well but the relevant data were not extracted by the authors.

In 1990 SSAU lost $83.2 million on its investments and in 1994 lost $324 million (SSAU annual reports), thus emphasising the investment risks involved and the potential for even greater losses as a greater proportion of its assets are allocated to equities.

Despite the major shift in its asset allocation, SSAU reported that an ISC Review of the fund in 1997 found only two minor points of criticism. This suggests that (1) the ISC was satisfied with the asset allocation (2) the ISC was powerless to do anything about it in terms of the relevant SIS covenant as set out in s.52, or (3) the ISC did not look at SSAU's asset allocation. Given the size of SSAU's change in the relevant asset allocation, one would have thought that either the 1988 allocation or the 1998 allocation was questionable and that it would have drawn criticism from the ISC. The relevant ISC report was not made available to members of the fund. The ISC claimed at the time that the privacy provision in SIS precluded the regulator from releasing such reports to members!

Without the exposure to normal market forces, trustees can also aim to badly err on the side of caution, and so relevant superannuants will derive sub-optimal retirement benefits. This is so because of the apparent lack of concern in s.52(2)f(ii), with investment return, especially low returns caused by overly cautious investment plans. This is relevant to benefit protection because of the importance of investment return to the ultimate size of benefits derived (eg. Hely, 1990). The Institute of Actuaries in Australia has expressed its concern about one facet of overly conservative superannuation investment policies, in publicity regarding short termism (IAA, 1996). An ad hoc review of the investment objectives of selected funds that do comply with s.52 shows that trustees commonly set very low investment goals (eg. anything above inflation) and applaud their own

management (in various ways) when those objectives are achieved. Clearly members of such funds are bound to suffer economic losses.

The following point does not involve investment strategy per se, it does have an effect on returns derived by superannuation fund members and hence the potential liability of employers for economic loss suffered by relevant employees..

Superannuation contributions under the superannuation guarantee legislation can be over a year late, but the benefit protection standards are silent on this point. While s.19 of the Superannuation Guarantee (Administration) Act (SGA) implies that superannuation guarantee payments are to be made quarterly, the relevant legislation has not been promulgated and so relevant payments need only be made annually - by the 28th day after the end of the relevant year (SGA s. 23(6A)). This means that:

(a) as compared other remittances which are due within 28 days of the end of the month in which they have been withheld from employees or are otherwise due, SG contributions can be over a year after effectively being deducted from employee wages[1] ie. over a year late.

(b) no investment income is derived on those contributions for the first year and thus this means a significantly lower final benefit for members. For example, $1 per year invested at 5% for 40 years accrues to $120.8 while the same investment for 39 years accrues to $115.1. Thus a significant difference in final benefit results.

(c) because of the delay in remittance of SG contributions, employee superannuation benefits are at greater risk especially in small businesses where the attrition rate is high.

Clearly the relevant legislation fails to protect many superannuants adequately in this regard.

5.2 Category (b) fund policies resulting in inequitable distribution of fund assets

[1] Various sources suggest that all superannuation contributions are deferred employee income eg. Dawkins, 1992.

Superannuation Industry Supervision Regulation (SISR) 5.04 makes provision for minimum benefits in regulated superannuation funds.

In defined contribution (accumulation) plans (DCPs) minimum benefits are (SISR 5.04(2)):

(a) member financed benefits (member contributions), plus

(b) mandated employer contributions (ie. employer contributions under SG legislation or an industrial award or agreement), including

(c) by virtue of the definitions in SISR 5.01, the net investment earnings on both employee and employer contributions.

In defined benefit plans (DBPs), minimum benefits are the same as above unless "... the member belongs to a class of employees in relation to which a relevant benefit certificate applies, [in which case, minimum benefits are] the amount of the member's minimum requisite benefit" (SISR 5.04(3) - emphasis added).

Benefits that have been rolled over or transferred into a fund are also minimum benefits.

Given that politicians tend to be tardy reactionaries rather than being proactive reformists, one can only deduce that minimum benefit provisions were introduced to counter inequitable practices such as long vesting schedules which were often used to benefit some superannuation fund members at the expense of others. However, the minimum benefits provisions are a failure because they do not preclude earlier abuses of superannuants. This view is supported by AAS 25 (para.24) which still refers to "forfeited benefits". This failure of relevant provisions is not apparent because the protection that members should have for their equitable interests in superannuation funds is buried in legislation worded in a way that facilitates deception and deprival of the reasonable benefits intended by the relevant Division of SISR.

Option (a) above is comparable to the fairest option available to DCPs (ie. no reserving). Option (b) is comparable to the DCP arrangement which permits the build up of reserves which can be dealt with in a variety of ways, including inequitable ways similar to cherry picker schemes. However, option (c) clearly empowers trustees to engage in cross subsidisation between DBP members, thus depriving the majority of members of optimal returns so that a minority of members derive returns (considerably) in excess of most members of the same fund. This has been an on-going problem, especially in the current prolonged period of wage restrain for most Australian employees. Benefit cross subsidisation occurs in (funded) DBPs because benefits are based on final average salary or highest average salary (for a detailed discussion, see Scheiwe, 1996 a, b, & c 1997 a, b, & c). Clearly this is inequitable and contrary to the intended purpose of the benefit protection legislation.

The industry explanation/justification of cross subsidisation is that in a DBP, employer contributions are made to a pool of funds, not made on behalf of individual members. Consequently (it is argued), the pool of funds (plus earnings on same) can be used for cross subsidisation purposes. This is contrary to the understanding of many superannuants and clearly disadvantages many DBP members relative to DCP members, especially in times of government and employer restrain on salary increases for the majority of relevant employees. Unions which do not act on this problem are failing their members, and arguably trustees are in breach of the covenants to act in the best interests of [ALL] members and to act honestly (SIS s.52(2)). Given that senior management are best placed to take advantage of this DBP loophole, it also seems highly desirable to review the right of employers, to equal representation on (relevant) superannuation trustee boards (see Scheiwe, 1997c).

5.3 Category (c) lack of control over operating costs

Since there is no annual general meeting of superannuation fund members at which they can exercise rights similar to those of shareholders, effectively there is no member control

over the operating costs of superannuation funds. The only option available to disgruntled fund members is to launch a civil action.

This section of the paper has shown that superannuants do not enjoy statutory protection against economic losses that may occur as a result of investing in particular superannuation funds, but the question remains, do they have civil recourse in respect of such losses?

6.0 Are the trustees liable for any economic loss suffered by the employees forced into membership of the fund that those trustees administer?

On the one hand, s. 58(1) of SIS provides that trustees of non-excluded funds are not subject to direction by any other person, and s.57 indemnifies those trustees provided they comply with relevant legislation and the relevant trust deed. On the other hand, trustees are personally bound by statutory covenants (s.52(8)) and must exercise a reasonable degree of skill and care. While s.55(3) permits persons to sue trustees for damages arising from the breach of relevant statutory covenants, s.55(5)m permits the defence in the case of investment losses, of acting in accordance with an investment strategy prepared by the trustees under s.52(2)f. However, that protection is not extended to employer sponsors of the relevant funds.

7.0 Is it possible that the employer sponsor may be liable?

In the context of this paper, it appears that employers do owe a relevant duty of care to their employees for three reasons.

- First if the employers choose which superannuation fund their employees are (effectively) required to contribute to, then clearly they have an on-going responsibility to ensure that those employees are not disadvantaged by that decision.
- In addition, in superannuation funds other than public offer funds, s.93 requires that there be equal employer and employee representation on trustee boards. Therefore employers are put in a position whereby they can monitor all aspects of the operation

of relevant superannuation funds.

- Finally, it is widely acknowledged that superannuants are not financially literate (ALRC, 1992) and therefore are likely to be reliant on the business expertise of the employer/mangers who decide which fund to specify and/or the terms of relevant fund trust deeds (if they are involved in determining same).

In regard to the last point above, employers could argue that the (sub-optimal) superannuation arrangements were all that employers were prepared to offer. This may protect them from an action for breach of contract, but not against an action for negligence.

In such situations it has also been argued (Scheiwe, 1997c) that trustees who do not bring the shortcomings of relevant arrangements to the attention of the fund members, are in breach of their duty to act honestly and in the best interest of (all) the members (S.52). If the trustees were found liable under these circumstances, this in turn would mean that (a) they would not enjoy statutory indemnity for relevant losses and so would be personally liable, and (b) the relevant employers may be liable for the actions of their employer representatives on the board of trustees. The problems alluded to above are discussed in detail in Scheiwe (1997c).

To summarise this section, it is argued that employers are vulnerable to a negligence suit for economic losses suffered by employees either as a result of the relevant superannuation arrangements per se, and/or as a result of the way the fund is operated.

8.0 Does choice of investment within specified funds overcome employer liability?

Investment choice does not remove employer liability for economic loss suffered by employees forced into specified superannuation funds because such arrangements do not:

- ensure that investment performance of the particular fund is optimal ie. a particular employee may derive a better return from a particular category of investment if s/he

were in a different fund. Put another way, the return of the balanced sub-plan of specified plan A, may be consistently less than the return of the balanced sub-plan of non-specified plan B, with no additional exposure to risk.

- if choice of investment is offered by a defined benefit plan, then this does nothing to ensure that cross subsidisation between members does not occur. Thus the majority of members of such funds may continue to derive sub-optimal returns.
- investment choice does not protect members from high operating costs and/or inefficient management of their superannuation fund

9.0 Conclusion

Where employees are required to be members of a superannuation fund either under an award or superannuation guarantee arrangements, and the relevant employer specifies the fund that those employees must be in, then those employers may be liable for economic losses suffered by the relevant employees as a result of the terms of the trust deed and/or because of the way the fund was run.

Choice of investment with specified funds does not eliminate employer liability. The only way that employers can avoid liability for economic losses suffered by employees, is by not making the choice of fund decision ie. by giving employees choice of fund. Employers should also consider whether having equal representation on trustee boards is worth the risk of liability, especially in DCPs and in DBPs in which the employer does not guarantee the relevant defined benefit.

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Superannuation: negligence and the labour union.

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Superannuation: negligence and the labour union.

Abstract

Many Australian superannuation fund trustees enjoy the protection of the veil of incorporation and no trustees are liable for fund performance, provided they abide by the Superannuation Industry Supervision Act and their fund's trust deed. However, many unions accept that often employers require their employees to be members of a particular superannuation fund as a condition of employment. If, as a result of being a member of the employer-specified fund, an employee suffers economic loss, relevant fund trustees are protected from legal action, but there is no statutory protection for unions which negotiated terms of employment that included forcing relevant employees into specified superannuation funds. Accordingly, it appears that relevant labour unions may be liable for economic losses suffered by relevant superannuation plan members provided it can be shown that such losses resulted from the union's failure to take reasonable care in the choice and/or monitoring of the particular fund. In many cases such losses are reasonably foreseeable because they are the result of (a) protracted poor management by trustees (half of whom are likely to be union appointees/representatives), and/or (b) misleading and inequitable superannuation arrangements.

Superannuation: negligence and the labour union.

1.0 Introduction

In this paper the term "negotiating union" means a labour union which reached agreement with an employer, under which employees (union members and others) are forced to be members of a superannuation fund specified by the employer and union.

In Australia, the federal government requires most employees to be in some form of superannuation, and consequently many employers force their employees to be in superannuation funds which they specify either alone or in collaboration with relevant unions. Thus normal market conditions are not able to function with the result that many superannuants are suffering economic losses ie. deriving sub-optimal superannuation benefits. Therefore it follows that labour unions may be partly liable for economic losses of employee-members of the specified superannuation plans, if they result from the union's negligent choice of fund and/or failure to monitor fund management and performance. Had the employees been at liberty to choose which fund they joined, then the union's liability would not have arisen.

Given that some 91% of Australian employees are covered by superannuation (APRA web page, March 1999), the potential for litigation is very substantial, as Table 1 below confirms. That table provides details of the size, membership and distribution of superannuation funds in Australia.

Table 1

Type of plan	Members	Members	Funds	Funds	Assets	Assets
	'000	%	#	%	$' billion	%
Corporate	1341	7	3463	2	68	18
Industry	5910	30	101	0	28	7
Retail	9003	46	249	0	107	28
Excluded	358	2	182589	98	50	13

Total private sector	**16612**	**85**	**186402**	**100**	**253**	**65**
Public sector	2877	15	41	0	85	22
Annuities, life office reserves, etc	Na	na	na	Na	49	13
Total	**19489**	**100**	**186443**	**100**	**387**	**100**

Source: APRA web page. March 1999

Since Australian superannuation funds had assets of $387 billion in March 1999, if only a 1% economic loss were suffered by all fund members, then there would be an annual claim of $3.87 billion. As is shown later in this paper, in many cases the relevant percentage loss by superannuants is much higher. In view of the size of Australia's superannuation industry, it is quite feasible that other financial institutions will also perform sub-optimally because they face less competition from the superannuation industry.

Even though the federal government continues to require Australian employees to contribute to superannuation, it has failed to ensure that the industry operates optimally either by direct action or by empowering superannuation fund members (Scheiwe, 1996). In addition, there appears to be no evidence that relevant unions are acting to optimise the benefits that their employee/members derive from the superannuation funds they jointly specified.

It may well be that unions accept superannuation arrangements proposed by employers during relevant negotiations, because they are unaware of the deficiencies of various superannuation arrangements. For example, in many cases, unions may not have been aware that the basic benefits of a superannuation scheme have been set low in order to minimise the chance that the employer may have to top up any deficiency in a relevant defined benefit plan. Such deficiencies are masked by arguments in favour of DBPs eg. the benefits keep pace with inflation or the employer "guarantees " the defined benefit. Another reason to ensure that in some funds, most employees derive sub-optimal benefits, is that such arrangements fund far superior benefits for senior management because they control employee salary levels, which in turn determine the superannuation

benefits of the selected employees (Scheiwe, 1996c). Thus employers selectively reward some employees at no additional cost to themselves. If unions hold themselves out as being competent to enter into relevant negotiations on behalf of employees, then they must be aware of these "pitfalls" and act accordingly.

Because so many employees will derive sub-optimal retirement benefits, the federal government's retirement incomes policy will fail since the majority of retired employees will be forced to rely on aged pensions to a considerable extent. Thus 91 % employee superannuation coverage does not mean that 91% of retirees will have adequate retirement incomes without an aged pension.

Table 2 below shows the proportion of non-excluded superannuation funds in each of three categories: defined contribution, defined benefit, and hybrid. It therefore shows that 26% (14% DBP and 12% Hybrid) of Australian superannuants may be adversely affected by the negative aspects of defined benefit plans referred to above ie. 2,903,000 superannuants .

Table 2

Jun-99

Non-excluded superannuation funds in Australia

	Type of Fund					Membership ' 000				
Sector	DCP	DBP	Hybrid *	Total	%	DCP	DBP	Hybrid *		%
Public	32	16	30	78	2	722	214	1872	2808	15
Private	2683	520	431	3634	98	15740	196	621	16557	85
Total	2715	536	461	3712		16462	410	2493	19365	
%	74	14	12		100	85	2	13		100

* Partly DCP & Partly DBP

Source: APRA web page

How can such an unsatisfactory situation arise and be sustained?

On the one hand, the superannuation industry claims that the covenants and operating standards incorporated into the Superannuation Industry Supervision Act (1993) ensure that members' superannuation investments are well protected.

However, on the other hand, an analysis of the relevant legislation reveals that many of the provisions setting out these key safeguards are quite ineffective (Scheiwe, 1999a).

Consequently, those people who invest in superannuation are in a far more vulnerable position than those people who invest in Australian corporations (Scheiwe, 1999b). In view of the ineffectiveness of the legislation, it is not surprising that successive regulators of Australian superannuation have a very poor record of enforcement (see ISC annual reports). Thus, it has been claimed that Australia's superannuation regulatory system is the product of regulatory capture by the industry (eg. Taylor and Little, 1993). Consequently superannuants have far less rights than shareholders and therefore have far less financial protection (Scheiwe, 1999a).

These factors, together with the employer's greater awareness of their civil rights and solicitors' willingness to launch speculative actions with contingency fees (no win/no fee) means that Australian superannuation is likely to see litigation for the recovery of economic losses sustained by fund members.

1.1 Australia's present superannuation regime

For many years Australian superannuation was "regulated" by a few provisions of the Income Tax Assessment Act and the trust/trustee acts of the states. This state legislation applied because some 94% of superannuation funds are trusts (Quinlivan, 1994). However, state trust/trustee acts are quite inappropriate for superannuation funds (ALRC, 1992) eg. because of:

(a) the rule against perpetuities

(b) they did not envisage large numbers of members

(c) they were mainly written with deceased estates in mind

In 1987 the federal Labor government introduced the Occupational Superannuation Standards Act (OSSA) and the Insurance and Superannuation Commission (ISC) became the superannuation industry regulator. However, it was soon claimed that OSSA was deficient in that the only action that the ISC could take regarding delinquent trustees, was to withdraw tax concessions to their fund, thus penalising innocent members. Accordingly the Superannuation Industry Supervision Act (SIS) replaced OSSA in 1993. SIS has been amended numerous times since then. For example on 1.7.1998, the Australian Prudential Regulation Authority (APRA) replaced the ISC. At the same time, responsibility for excluded superannuation funds (sic, those with less than 5 members) was given to the Australian Taxation Office (ATO), while reporting and consumer protection responsibilities were given to (the new) Australian Securities and Investments Commission (ASIC). APRA was also given responsibility for the wider prudential supervision of various deposit taking institutions which were previously regulated by state legislation eg. building societies and friendly societies. Therefore the regulation of Australian superannuation funds is currently shared by three agencies which also have onerous regulatory responsibilities. This is hardly a satisfactory situation.

When it effectively introduced compulsory superannuation (in the form of superannuation guarantee legislation), the Australian federal government was not going to be directly involved in the superannuation regime it introduced (eg. by operating a federal government superannuation scheme). As can be seen from Table 2, the federal government has allowed the private sector to operate 98% of Australian superannuation plans. These were mainly corporate funds set up under industrial awards, or retail (ie. public offer) funds (see Table 1). This approach avoided undermining existing superannuation providers and minimised the federal government's cost of implementing its retirement incomes policy.

SIS has placed heavy reliance on plan trustee compliance, auditor whistle blowing, and member monitoring of their plans. This explains the ISC statement that an informed membership is a central plank in the regulation of Australian superannuation industry and that the relevant regulatory system is "market oriented" (Brown et al, 1994).

Even though the ISC used to undertake some plan reviews to check on whether the prudential safeguards in the relevant legislation were being followed, the number was so small that the ISC conceded that member monitoring is critical to ensuring that plans are properly run. APRA appears to be of the same view.

Unfortunately the relevant legislation does not put superannuation plan members in a position from which they can ensure that their plans are properly run (Scheiwe, 1999c). Hence the Australian system for regulating the superannuation industry is fundamentally and serious flawed in that:

- on the one hand, superannuants are not provided with information which allows them to decide if their plans are well run, and do not have the power to rectify the situation if they are dissatisfied. Not surprisingly, Ambrovich (1994) claims that there is a burgeoning of dissatisfaction with superannuation benefits and entitlements.
- on the other hand, superannuants are not given the statutory protection that their vulnerability deserves. This vulnerability is exacerbated by the fact that The Superannuation Complaints Tribunal always had very limited powers by virtue of s.14 of the Superannuation (Resolution of Complaints) Act, and even these were ruled unconstitutional in Wilkinson v Clerical Administrative and Related Employees Superannuation Fund Pty. Ltd., 1998.

1.2 Proposed choice of fund legislation

The current Australian Treasurer identified the following government objectives for Australia's financial system (Costello, 1997):

- increase competition
- improve efficiency

- preserve integrity

Clearly the government was concerned about superannuation fund performance. Accordingly, the Howard government sought to introduce choice of fund legislation in 1998 and in 1999 (Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill, 1998). Under the proposal employers were to give employees either limited choice of fund or unlimited choice of fund. Which option was chosen was a decision for each employer.

Limited choice of fund option meant allowing employees to choose a fund from at least four nominated by the employer, being at least one from each of four categories below:

- at least one public offer fund
- at least one retirement savings account (RSA)
- a standard employer fund to which the employer contributes or a relevant public sector fund
- at least one relevant industry fund

The limited choice of fund model did not include private (ie. DIY) funds.

The unlimited choice of fund model meant that employees could chose any fund they wished and the employer would forward superannuation contributions to it. Most (large) employers pay employees by electronic funds transfer to individual bank accounts in order to minimise relevant costs. Thus it seems that the same facility would be equally effective for superannuation, unless the employer was gaining some other advantage from restricting choice of fund.

The superannuation industry lobbied vigorously against the proposed legislation, and many funds introduced choice of investment (within the one existing fund) to undermine the argument for choice of fund. Basically three choices are given by relevant funds . These are summarised in the following table.

Common names	Assets	Risk	Possible Return
Capital guaranteed	Mostly cash and fixed deposits	Low	Lowest
Balanced	Limited cash and fixed deposits, property, equities	Medium	Medium
Capital growth or market linked	Mostly shares and other equities	Highest	Highest

Unfortunately the above bill was not passed by the federal parliament and so many Australian superannuants continue to suffer economic losses as a result of being forced into superannuation funds that they did not choose.

2.0 Economic loss suffered by employees

It has been asserted in this paper that many members are deriving sub-optimal returns from their superannuation funds. Some explanation of how that occurs has already been given above, but the assertion is further supported by the Australian Society of Certified Practising Accountants (1991) and by Ambrovich (1994). Table 3 below also supports that view. It compares the investment returns of 6 categories of superannuation plans and 10 categories of investment funds (various investment strategies in each case) operated by the same large financial institution in Australia. Clearly the average return for the superannuation funds is much lower than for the investment funds.

Table 3

Comparison of super fund and investment fund returns
(7 year ROR to 1.7.1998)

Super 6 plans %	Invest 10 pools %
9.32	15.67
9.23	14.84
9.29	12.54
9.33	9.9
4.94	22.63
3.25	10.6

	8.69	21.87
	7.98	23.11
	4.84	6.16
	8.73	27.12
	7.96	16.61
	4.7	1.99
		10.79
		10.59
		5.81
		5.48
Average	7.36	13.48

Source
BT Investors Circle, Winter 1998

In the context of this paper, "superannuant" means a member of a superannuation fund, and "economic loss" means that the superannuant derived a lower increase in retirement benefits as a result of the operation of his/her mandatory fund than s/he could have derived as a member of a fund that s/he would have chosen if allowed choice of fund. Thus an economic loss is different from an accounting loss in that an accounting loss would mean lower benefits at the end of the relevant period than at the beginning of same. Economic loss simply means that the member could have derived a higher accumulated benefit at the end of the relevant period (after allowing for contributions) than was actually the case.

Anyone can be wise in hindsight, and so many economic losses can be regarded as simply a normal risk involved in business and investing. However, this paper is not concerned with those economic losses. It is concerned with economic losses which can be reasonably anticipated and therefore reasonably avoided.

How can such economic losses be incurred by superannuation fund members? Broadly there are three categories of ways:

(a) sub-optimal investment strategies (and hence investment returns)

(b) failure to pass on investment income to members equitably

(c) a lack of control over fund operating costs

Each of these is discussed below.

Category (a)

The following are examples of sub-optimal investment strategies:

(i) an overly cautious investment strategy (eg. an unusually high proportion of investment assets in cash and fixed deposits, rather than adopting a more balanced or aggressive investment strategy). Such a strategy may be justified where the vast majority of members are near retirement, but is not justifiable for a "normal" fund that is not in an advanced stage of decline. A highly liquid investment strategy may be adopted by such a fund if the trustees are not diligent enough to manage the investments themselves or not diligent enough to engage experts who can manage the fund's investments properly.

The performance of the Tertiary Education Superannuation Scheme (TESS) may illustrate this point. Quite remarkably, TESS's performance improved in 1997 when it was faced with public criticism and the prospect that new member choice legislation may allow TESS members to transfer to a new competitor . In 1997, TESS reported a return of 21%. For the years 1990 to 1996 it reported the following returns (before deducting operating costs): 14.9%, 14.2%, 9.4%, 7.6%, 5.6%, 5.4%, 7.6%. TESS's performance did not rate well in comparison with other industry funds and its dramatic turn-around in 1997 was not typical of the industry. The dramatic change in returns was due to an equally dramatic increase in reported change in market value of investments. One trustee claimed that the fund had previously been (sic) "locked into bad investments".

Overly conservative investment strategies in any superannuation fund need not be the result of a lack of diligence on the part of trustees. They may also be the result of not investing at arm's length. For example, investing so as to obtain a directorship for an influential trustee (and hence personal gain), rather than investing so as to optimise investment return for the superannuation fund and its members. Another example may involve investments brokered by relevant trustees to earn commissions for particular unions.

(ii) an overly optimistic investment strategy may also produce sub-optimal, if not disastrous results. While SIS (s.52) contains a covenant which requires trustees to formulate and give effect to an investment strategy which takes cognizance of risk, return, and liquidity, APRA is powerless to take action unless it is obvious that more enforceable SIS provisions have been breached eg.

- breaching the sole purpose test (s.62), as illustrated by cases where the trustees were using the fund's assets to finance their own businesses or pleasure activities in contravention of the in-house asset rule which is set out in s.69 (eg. Gray and Dorkins, 1996), or
- breaching provisions of the fund's trust deed (eg. Gallery and Sharples, 1994).

Category (b)

The following are examples of fund policies that do not result in an equitable distribution of fund income:

(i) excessive reserving of fund income in defined contribution (aka. accumulation) funds. Trustees have a statutory right to maintain reserves (SIS s.115). If properly used, reserves allow fund administrators to even out benefits between times of economic boom and economic downturn. However, there is no statutory control over the level of such reserves, though the ALRC (1992) has stated that reserves up to 20% of accumulated benefits are acceptable. Consequently reserving was so misused in conjunction with vesting provisions in trust deeds, that some funds were referred to as "tontine" or "cherry picker schemes" (Batroney, 1991). In such schemes, large reserves were established and the scheme was wound down in various ways (eg retrenchments, transfer of members to other intra group companies etc) until only a select few members were left and then the entire reserve was shared between the remaining few.

(ii) long vesting schedules. Vesting refers to whether the employer's contribution to the superannuation fund has been allocated to the members, and can therefore be "taken" with the members when they leave that particular fund. Long vesting schedules meant that employees had to be in the employ of contributing employers for many years before

they could take (any of) the employers contributions with them if they left that employer. As a result of voluntary and involuntary staff turnover, funds accumulated far more employer contributions than had been contributed on behalf of remaining members. Hence the fund could afford to pay very generous benefits to those who remained (or were allowed to remain) in the fund. The benefit protection provisions in SIS regulations (viz. SISR Part 5) require vesting of mandated employer and all employee contributions but does not make adequate provision for the vesting of non-mandated contributions or fund income and allow cross subsidisation within DBPs (Scheiwe, 1999b). Consequently the superannuation abuses outlined above still continue

(iii) overly conservative actuarial assumptions in defined benefit plans and hence overly conservative defined benefit formulae. These ensure that those people with high salary increases near the end of their membership of funded defined benefit funds will derive superior returns as compared most members of the fund.

In addition, manipulation of actuarial assumptions has been used to artificially inflate surpluses which have then been repatriated to employers (Benedict, 1991). The superannuation spokesman for the Australian Institute of Chartered Accountants referred to that practice as "legalised robbery" (Brown, 1992). Surpluses can still be repatriated under SIS (s. 117).

Category (c)

In this paper, "operating costs" of funds includes trustee remuneration and premiums paid for life and/or disability insurance. There is no control over the operating costs of Australian superannuation funds because effectively the trustees are not accountable to anyone. This is so because there is no statutory requirement for Australian superannuation funds to have (annual) general meetings at which members (like shareholders):

- elect trustees
- appoint the auditor
- have the auditor report to them

- approve audited financial statements (which were automatically sent to members)
- set trustee remuneration
- express opinions on fund policy
- etc.

In addition, the accounting standard for superannuation (AAS 25) caused so much tension between the superannuation industry and the accounting profession (Klumpes, 1994) that there is no statutory backing for **any** accounting standard relevant to superannuation. Hence there is no statutory requirement to report related party transactions, even though SIS requires investment transactions to be conducted at arm's length (s.109).

The above aspects of the Australian superannuation regulation stand in stark contrast to the provisions relating to companies (which can be regarded as an alternative type of investment vehicle). Thus one should be concerned that if shareholders suffered the abuses of the 1980s despite better rights and hence regulatory protection, then superannuants must be vulnerable to at least similar losses.

4.2 Are the above problems wide spread?

The authors are not aware of any comprehensive study of the absolute performance of Australian superannuation funds. However, the following points can be made:

(i) it is widely acknowledged that most fund managers don't beat relevant indices

(ii) anecdotal evidence strongly suggests that many superannuation fund members are deriving sub-optimal returns. This is masked by the fact that funds are encouraged to report investment returns and these may be very different from the return derived by members because investment return ignores fund operating costs and fees imposed on members, and also ignores cross subsidisation and reserving as described above. While crediting rates must be reported in member benefit statements, they may also ignore various charges imposed on fund members, and so create a false impression of the rate of return derived by members.

5.0 What statutory protection is currently available to members?

As in section four of this paper, this discussion will use the three categories of ways that superannuation fund members can suffer economic loss.

5.1 Category (a) inappropriate investment strategy

The benefit protection standards are silent regarding overly conservative investment plans which result in sub-optimal benefits. SIS s.52(2)f requires trustees to "formulate and give effect to an investment strategy that has regard to (sic) risk, diversification, liquidity, and fund liabilities. This provision has been applied in conjunction with the sole purpose test (SIS s.62) to protect superannuants eg. from:

(a) unscrupulous employers who seek to use the funds as (i) a personal source of finance for their businesses (despite the restriction on in-house assets) or (ii) for their pleasure (Lavelle, 1995).

(b) honest but bad investment management of superannuation funds eg. the case the trustee of an excluded fund who had a penchant for playing the stock market, much to the detriment of the fund's assets, and in another case where the trustees invested in only two areas, one of which did not appreciate and one of which was badly affected by the Asian financial crisis in the second half of the 1990s (Griffith, 1998). The fund reported a –43% return for 1998. In both cases the trustees did not diversify the investments because they thought they could generate superior returns from specialised investments.

Overly optimistic investment strategies can have an even worse long term result than overly conservative policies. While each fund's investment strategy must be reported to members, this can be done in such a way that members who do not undertake a detailed analysis of their fund (ie. the vast majority) can be lulled into a false sense of satisfaction. This is illustrated by considering the national superannuation scheme for Australian university staff. This is called Superannuation Scheme for Australian Universities (SSAU). The trustees have emphasised in recent annual reports that the fund's investment return in the top quartile, and have even promulgated a glowing report on the fund which was published in "Superfunds", the magazine of the Association of Superannuation Funds of Australia. In contrast, trustees did not promulgate the views of Darly Dixon, an

Australian financial adviser and well known and respected commentator on superannuation. He described this fund on ABC radio as "a national disgrace" and "Australia's biggest slush fund". He was also critical of the fund in an article in The Bulletin (Dixon, 1999). Table 4 below shows that SSAU's above average investment returns were due to a major change in investment strategy which made it far riskier than previously, and far riskier than most Australian superannuation funds. Like the Dixon article, this point was not emphasised in SSAU's annual reports to members.

Table 4

(see separate page)

The table above shows that:

- the proportion of SSAU's investment assets which were allocated to equities (Australian and overseas) rose from 40% in 1988 to 75.4% in 1998
- SSAU's asset allocation was significantly different from the national average allocation in 1994, 1996, and 1998. It may also have been different in other years as well but the relevant data were not extracted by the authors.

In 1990 SSAU lost $83.2 million on its investments and in 1994 lost $324 million (SSAU annual reports), thus emphasising the investment risks involved and the potential for even greater losses as a greater proportion of its assets are allocated to equities.

Despite the major shift in its asset allocation, SSAU reported that an ISC Review of the fund in 1997 found only two minor points of criticism. This suggests that (1) the ISC did not review the asset allocation, (2) the ISC was satisfied with the asset allocation or (3) the ISC was powerless to do anything about it in terms of the relevant SIS covenant as set out in s.52. Given the size of SSAU's change in the relevant asset allocation, one would have thought that either the 1988 allocation or the 1998 allocation was questionable and that it would have drawn criticism from the ISC. The relevant ISC report was not made

available to members of the fund. The ISC claimed at the time that the privacy provision in SIS precluded the regulator from releasing such reports to members!

Without the exposure to normal market forces, trustees can also aim to badly err on the side of caution, and so relevant superannuants will derive sub-optimal retirement benefits. This is so because of the apparent lack of concern in s.52(2)f(ii), with investment return, especially low returns caused by overly cautious investment plans. This is relevant to benefit protection because of the importance of investment return to the ultimate size of benefits derived (eg. Hely, 1990). The Institute of Actuaries in Australia has expressed its concern about one facet of overly conservative superannuation investment policies, in publicity regarding short termism (IAA, 1996). An ad hoc review of the investment objectives of selected funds that do comply with s.52 shows that trustees commonly set very low investment goals (eg. anything above inflation) and applaud their own management (in various ways) when those objectives are achieved. Clearly members of such funds are bound to suffer economic losses.

The following point does not involve investment strategy per se, it does have an effect on returns derived by superannuation fund members and hence the potential liability of unions for economic loss suffered by relevant employees..

Superannuation contributions under the superannuation guarantee legislation can be over a year late, but the benefit protection standards are silent on this point. While s.19 of the Superannuation Guarantee (Administration) Act (SGA) implies that superannuation guarantee payments are to be made quarterly, the relevant legislation has not been promulgated and so relevant payments need only be made annually - by the 28th day after the end of the relevant year (SGA s. 23(6A)). This means that:
(a) as compared other remittances which are due within 28 days of the end of the month in which they have been withheld from employees or are otherwise due, SG

contributions can be over a year after effectively being deducted from employee wages[1] ie. over a year late.

(b) no investment income is derived on those contributions for the first year and thus this means a significantly lower final benefit for members. For example, $1 per year invested at 5% for 40 years accrues to $120.8 while the same investment for 39 years accrues to $115.1. Thus a significant difference in final benefit results.

(c) because of the delay in remittance of SG contributions, employee superannuation benefits are at greater risk especially in small businesses where the attrition rate is high.

Clearly the relevant legislation fails to protect many superannuants adequately in this regard.

5.2 Category (b) fund policies resulting in inequitable distribution of fund assets

Superannuation Industry Supervision Regulation (SISR) 5.04 makes provision for minimum benefits in regulated superannuation funds.

In defined contribution (accumulation) plans (DCPs) minimum benefits are (SISR 5.04(2)):

(a) member financed benefits (member contributions), plus

(b) mandated employer contributions (ie. employer contributions under SG legislation or an industrial award or agreement), including

(c) by virtue of the definitions in SISR 5.01, the net investment earnings on both employee and employer contributions.

In defined benefit plans (DBPs), minimum benefits are the same as above unless "... the member belongs to a class of employees in relation to which a relevant benefit certificate applies, [in which case, minimum benefits are] the amount of the member's minimum requisite benefit" (SISR 5.04(3) - emphasis added).

[1] Various sources suggest that all superannuation contributions are deferred employee income eg. Dawkins, 1992.

Benefits that have been rolled over or transferred into a fund are also minimum benefits.

Given that politicians tend to be tardy reactionaries rather than being proactive reformists, one can only deduce that minimum benefit provisions were introduced to counter inequitable practices such as long vesting schedules which were often used to benefit some superannuation fund members at the expense of others. However, the minimum benefits provisions are a failure because they do not preclude earlier abuses of superannuants. This view is supported by AAS 25 (para.24) which still refers to "forfeited benefits". This failure of relevant provisions is not apparent because the protection that members should have for their equitable interests in superannuation funds is buried in legislation worded in a way that facilitates deception and deprival of the reasonable benefits intended by the relevant Division of SISR.

The "investment earnings" which form part of minium benefits (see SISR 5.04(2) above) are defined (SISR 5.01(1)) simply as whatever the trustees credit to each member's account (net of relevant costs). Provided fund operating costs are at a reasonable level, there is nothing wrong with that in a DCP which does not maintain reserves.

For DCPs that do maintain reserves, SISR provides that trustees are to determine the investment return to be debited or credited to a member's benefit from time to time, having regard to the return of the fund on investment, costs, and level of reserves (SISR 5.03(1)). Thus unscrupulous trustees are still empowered to operate inequitable schemes eg. build up reserves in a DCP under s.115 and eventually pay far superior benefits to a select few people left in a fund after other members/employees have been "dispensed with" in various ways. Such arrangements would be very similar to notorious cherry picker schemes that had long vesting schedules (see Batrouney, 1991).

Similarly, in DBPs, if members are not covered by a relevant benefit certificate[2], minimum benefits also include investment earnings on both member contributions and mandated employer contributions ((SISR 5.04(3)). As is the case for DCPs, SISR 5.01(1) provides that investment earnings for DBPs means whatever the trustees credit to each member's account by way of an investment return. However, "investment return" is defined (SISR 5.01(1)) differently for DBPs than for DCPs. For DBPs there are 3 possibilities:

(a) a proportionate share of the return on investments (based on benefits), or

(b) "the return on the benefits over that period that is fair and reasonable to all members of the fund, being a return based on either the actual return earned on the investments of the fund or on a commercially available rate of interest , or

(c) the return on the benefits that is derived by increasing the benefits in proportion with the increase in the salary of the member over that period.

Option (a) above is comparable to the fairest option available to DCPs (ie. no reserving). Option (b) is comparable to the DCP arrangement which permits the build up of reserves which can be dealt with in a variety of ways, including inequitable ways similar to cherry picker schemes. However, option (c) clearly empowers trustees to engage in cross subsidisation between DBP members, thus depriving the majority of members of optimal returns so that a minority of members derive returns (considerably) in excess of most members of the same fund. This has been an on-going problem, especially in the current prolonged period of wage restrain for most Australian employees. Benefit cross subsidisation occurs in (funded) DBPs because benefits are based on final average salary or highest average salary (for a detailed discussion, see Scheiwe, 1996 a, b, c 1997 a, b,c). Clearly this is inequitable and contrary to the intended purpose of the benefit protection legislation.

[2] Benefit certificates are issued to show that employer contributions in DBPs are (are not) meeting relevant SG obligations

The industry explanation/justification of cross subsidisation is that in a DBP, employer contributions are made to a pool of funds, not made on behalf of individual members. Consequently (it is argued), the pool of funds (plus earnings on same) can be used for cross subsidisation purposes. This is contrary to the understanding of many superannuants and clearly disadvantages many DBP members relative to DCP members, especially in times of government and employer restrain on salary increases for the majority of relevant employees. Unions which do not act on this problem are failing their members, and arguably trustees are in breach of the covenants to act in the best interests of [ALL] members and to act honestly (SIS s.52(2)). Given that senior management are best placed to take advantage of this DBP loophole, it also seems highly desirable to review the right of employers, to equal representation on (relevant) superannuation trustee boards (see Scheiwe, 1997c) and the defacto right of unions to represent fund members (both those in relevant unions and those not in relevant unions) on superannuation fund boards.

5.3 Category (c) lack of control over operating costs

Since there is no annual general meeting of superannuation fund members at which they can exercise rights similar to those of shareholders, effectively there is no member control over the operating costs of superannuation funds. The only option available to disgruntled fund members is to launch a civil action.

This section of the paper has shown that superannuants do not enjoy statutory protection against economic losses that may occur as a result of investing in particular superannuation funds, but the question remains, do they have civil recourse in respect of such losses?

6.0 Are the trustees liable for any economic loss suffered by the employees forced into membership of the fund that those trustees administer?

On the one hand, s. 58(1) of SIS provides that trustees of non-excluded funds are not

subject to direction by any other person, and s.57 indemnifies those trustees provided they comply with relevant legislation and the relevant trust deed. On the other hand, trustees are personally bound by statutory covenants (s.52(8)) and must exercise a reasonable degree of skill and care. While s.55(3) permits persons to sue trustees for damages arising from the breach of relevant statutory covenants, s.55(5)m permits the defence in the case of investment losses, of acting in accordance with an investment strategy prepared by the trustees under s.52(2)f. However, that protection is not extended to unions that negotiate employment conditions for employees (union members and others) forced into specified funds.

7.0 Is it possible that the negotiating unions may be liable?

In the context of this paper, it appears that negotiating unions do owe a duty of care to relevant employees for three reasons.

- First if the unions choose which superannuation fund that relevant employees are (effectively) required to contribute to, then clearly they have an on-going responsibility to ensure that those employees are not disadvantaged by that decision.
- In addition, in superannuation funds other than public offer funds, s.93 requires that there be equal employer and employee representation on trustee boards. In many cases, employee representative simply means that relevant unions appoint a person to the board. Not necessarily is a ballot of relevant employees is held to determine their representative. Therefore relevant unions are put in a position whereby they can monitor all aspects of the operation of superannuation funds.
- There is no requirement that the union appointee have superannuation expertise and therefore they are likely to be reliant on the business expertise of the employer/mangers who decide which fund to specify and/or the terms of relevant fund trust deeds (if they are involved in determining same).

In regard to the last point above, unions could argue that the (sub-optimal) superannuation arrangements were all that the employers were prepared to offer. This will not protect them from an action for negligence.

In such situations it has been argued (Scheiwe, 1997c) that trustees who do not bring the shortcomings of relevant arrangements to the attention of the fund members, are in breach of their duty to act honestly and in the best interest of (all) the members (s.52). If the trustees were found liable under these circumstances, this in turn would mean that (a) they would not enjoy statutory indemnity for relevant losses and so would be personally liable, and (b) the relevant employers may be liable for the actions of their employer representatives on the board of trustees. The problems alluded to above are discussed in detail in Scheiwe (1997c).

To summarise this section, it is argued that unions are vulnerable to a negligence suit for economic losses suffered by employees either as a result of the relevant superannuation arrangements per se, and/or as a result of the way the fund is operated.

8.0 Does it matter whether relevant employees are union members?

The key question regarding union liability for superannuation fund members' economic losses is whether they owe a duty of care to both union members and non-union members affected by their agreement with employers, to force employees into membership of specified superannuation funds.

Where the superannuation fund members who suffered an economic loss are union members, it can be argued that the union was acting on their behalf and did owe them a duty of care.

When economic losses are suffered by employees who are not union members, is there stiil a duty of care? Despite non-union members being third parties in this situation, it does appear that relevant unions would owe them a duty of care because they would be aware that such employees would be bound by agreements reached between the union and the employer.

9.0 Does choice of investment within specified funds overcome union liability?

Investment choice does not remove union liability for economic loss suffered by employees forced into specified superannuation funds because such arrangements do not:

- ensure that investment performance of the particular fund is optimal ie. a particular employee may derive a better return from a particular category of investment if s/he were in a different fund. Put another way, the return of the balanced sub-plan of specified plan A, may be consistently less than the return of the balanced sub-plan of non-specified plan B, with no additional exposure to risk.
- if choice of investment is offered by a defined benefit plan, then this does nothing to ensure that cross subsidisation between members does not occur. Thus the majority of members of such funds may continue to derive sub-optimal returns.
- investment choice does not protect members from high operating costs and/or inefficient management of their superannuation fund

9.0 Conclusion

Where employees are required to be members of a superannuation fund either under an award or superannuation guarantee arrangements, and the relevant employer specifies the fund that those employees must be in, then those negotiating unions may be liable for economic losses suffered by the relevant employees as a result of the terms of the trust deed and/or because of the way the fund was run.

Choice of investment with specified funds does not eliminate union liability. The only way that unions can avoid liability for economic losses suffered by employees, is by not making the choice of fund decision ie. by giving employees choice of fund. Unions should also consider whether having (equal) representation on trustee boards is worth the risk of liability.

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University superannuation: a case study in Australia's appalling superannuation regulations.

1.0 Introduction

The purpose of this paper is to illustrate by reference to the national superannuation arrangements for university staff (non-academic and academic) that Australia's superannuation regulatory system is a sham. Most of the points that will be made are not unique to university superannuation.

Euphemistically described, university superannuation is complex. Originally each traditional university had its own staff superannuation fund, but when colleges of advanced education (sometimes called by other names) were established, the relevant staff became members of their state's superannuation scheme. Many university staff are still members of these two types of scheme. However, some two decades ago, Australia abandoned its binary tertiary education system and the commonwealth took over control of all of our universities and colleges of advanced education then became known as universities. At the same time, some university superannuation funds were very financially embarrassed and as a result, on 24.12.1982, the University of Tasmania set up a new superannuation fund called "Superannuation Scheme for Australian Universities" (SSAU). Other similarly embarrassed universities quickly joined SSAU. Usually this meant that existing staff had the choice of changing to SSAU or staying in their former scheme, but new staff were forced into SSAU as a condition of employment. Over the next decade or so, all Australian universities (except Bond) joined SSAU so that a national occupational superannuation scheme existed for Australian university staff (academic and non-academic).

In addition, in 1988, the Tertiary Education Superannuation Scheme (TESS) was also established. This accepted the 3% productivity payment made under the accord between the Labor government and the union movement. TESS also receives superannuation contributions under the superannuation guarantee legislation for some university staff (eg. part time staff) not covered by SSAU or a predecessor fund. Some university staff who are still members of state government superannuation funds may also have their productivity

payment or superannuation guarantee (SG) contributions paid into a state superannuation fund. Therefore many university staff are members of both SSAU and TESS, some are members of only one of those funds, and some are members of neither. Arguably there is unnecessary complexity and duplication in the superannuation arrangements for staff of Australia's universities.

This paper is concerned only with SSAU which is a far bigger fund than TESS. At last balance date, SSAU's total assets were **$5,654,239,000** (31.12.1998) and TESS"s total assets were **$1,057,000,034** (30.6.1999).

For many thousands of university staff, SSAU is more accurately described as an organised crime rather than as a superannuation fund.[1] This is because they are forced into a fund which is cheating them, particularly those who remain in the original defined benefit plan (DBP). Despite government and industry assurances about prudential safeguards, SSAU is accountable to no-one and its members are being cheated out of the superannuation benefits which they are mislead into believing they are receiving as part of their remuneration.

The table below lists problems with SSAU (from a member's perspective) and highlights the relevant legislation that is supposed to protect superannuation fund members. Each of the problems and its associated legislative deficiency are discussed in general terms, and then in terms of SSAU.

Problem	**Legislation that should prevent this problem**	**Section # (a)**
(1)General	**Australia's superannuation regime is undemocratic and uncompetitive. Consequently it fulfils the industry's objective, not those of the members and those of government**	**N/a**
(1.1) To their detriment, university employees are forced into a particular fund	Nil. If choice of fund legislation remains stalled in the federal parliament then it is likely that employers and unions will face	N/a

[1] SSAU has also been described as "a superannuation scam" (Scheiwe, 1996), "a National disgrace" (Dixon, 1999), and as "Australia's biggest slush fund" (Dixon, 1999)

	negligence actions for economic losses sustained by relevant employees	
(1.2) Members are not involved in discussions about their superannuation	Nil. The legislation does not give members any say in the running of the fund which in equity belongs to them.	s.58
(2) Funds can deliberately sub-optimise member returns	**Some DBPs primarily maximize senior management's superannuation and financially protect sponsoring employers rather than maximising the benefits of all plan members.**	**s.62**
(2.1) Low benefit factor	Minimum benefits regulations	SISR Div 5.2
(2.2) Cross subsidisation	As above	
(2.3) Effectively the employing universities are contributing at less than the award rate.	Relevant administration costs have been transferred from universities to SSAU	s.117(4)
(3.0) Provision of information to members	**The superannuation industry claims that there are onerous reporting requirements imposed on funds, but is the information pertinent, understandable, or reliable? What is the point of this information if members can't act on it?**	**SISR sub-div.2.4.2, 2.4.3**
(3.1) Misleading rate of return reports	Members are deliberately mislead about the returns they are deriving from their superannuation fund	SISR 2.24, 2.29 AAS 25
(3.2) Misleading surplus reports	The surplus figure has been manipulated and members transferring to a new SSAU sub fund have not received their entitlement	s.52(2)a
(3.3) Misleading employer contribution advertisements	If SSAU is correct, most Australian universities are falsely advertising regarding superannuation	TP Act FT Acts
(3.4) Failure to report full trustees fees	Nil	Nil
(3.5) Generally deals with employers, not members. Employers control the fund.	Members have no say in the running of their fund but bear the cost of negotiations between the employer and the fund	s.58
(4.0)The SIS investment strategy covenant is a farce	**The SIS investment strategy covenant is touted as a key prudential control but it is unenforceable and does not necessarily protect fund members.**	
(4.1) SSAU: very low investment goals but far riskier investment strategy	This combination means that in good years, a surplus is inevitable, but	s.52(2)f

	members have no say.	
(5) Trustees	**SIS practically forces funds to have a corporate trustee because this is a constitutional and regulatory foundation of the relevant federal legislation. Consequently, trustees are accountable to no-one and the legislation is a travesty of justice.**	s.19
(5.1) SSAU and its trustee is accountable to no one	Dramatic changes in costs are not explained and cannot be challenged.	s.19
(5.2) Equal representation	The requirement for equal numbers of employer and employee trustees is unnecessary and a farce	s.89 s.52(2)e
(5.3) Election of trustees open to abuse	The legislation only refers to "appointment" not "supervised election".	s.107
(5.4) Trustees to exercise skill and diligence	Who monitors this?	s.52(2)b
(5.5) Act honestly in the interests of (all) beneficiaries	Is this possible for trustees of defined benefit plans?	s.52(2)c
(6.0)Complaints	**Even the toothless tiger (Superannuation complaints Tribunal) is dead. Members who are dissatisfied are deterred by the cost of civil litigation**	**s.101 SRCA s14. 15**
(6.1) Dissatisfied members are deterred from taking action.		

(a) Unless otherwise stated, section references are to the Superannuation Industry Supervision Act (SIS) and references to regulations are to the SIS regulations (SISR).

(1.0) General

Just how inconsistent Australia's superannuation regulatory system is with our social structure, is highlighted by comparing the rights (and hence protection) of superannuation fund members with the rights of company shareholders. Unlike shareholders, superannuation fund members don't: have annual general meetings; don't elect the relevant governing board of their investment vehicle; don't set the remuneration of same; don't automatically receive audited financial statements of their investment vehicle; don't appoint the relevant auditors or hear their reports; don't have the right to choose and change where they invest THEIR savings; etc

(1.1) To their detriment, university employees are forced into a particular fund

Effectively 24% of the salaries of more than 50,000 university staff are supposedly contributed to SSAU (21%) and TESS (3%), irrespective of whether this is what they want, or not. Unfortunately most SSAU members[2] do not get that contribution and the reasonable return on same, even though the latter are widely regarded as deferred income of the relevant employees. By Australian standards, this is a very high proportion of employee income that is commandeered. It is unfortunate that federal Labor and Democrat politicians appear to simply adopt a superannuation policy fed to them by big fund operators rather than developing policies which protect fund members who are their real constituents.

From 1982 to 1997 SSAU consisted only of a defined benefit plan. Following very public criticism of the fund, SSAU then became a two-scheme fund by offering members a once off choice of moving into a new defined contribution plan (DCP), or staying in the original defined benefit plan (DBP). One third of members opted to stay in the DBP, one third opted for the new plan, and one third did nothing, and by default stayed in the DBP. Within the DCP, members are given a choice of four investment strategies. Since then, some members have claimed that they were not given adequate information and want a second chance to change to the DCP. SSAU has refused. Optimally all employees should have unlimited freedom of choice of fund, not just choice of scheme within one fund or choice of investment strategy within a specified fund.

[2] SSAU now has over 50,000 members.

The deficiency with restricted choice such as mere investment choice, is that it does not generate the competition needed to make SSAU (or any fund) operate optimally. Industry arguments against choice of fund legislation are largely without foundation and are simply aimed at protecting and protracting inefficiency within the industry. This is especially so in large corporations whee there is a high degree of vertical integration of relevant financial services. Other financial institutions have always operated successfully with full consumer choice. The result of not giving employees unlimited choice of fund will be sub-optimal retirement benefits for Australian superannuants, the failure of the federal government's retirement incomes policy, and consequently increased taxes.

At the August 1999 meeting of SSAU's consultative committee (see later), the author of this paper handed out a questionnaire about choice of fund. While there response rate was low, there was overwhelming support for choice of superannuation fund and similar support for the suggestion that if relevant legislation is not introduced, universities should voluntarily introduce choice of fund since they have sought to be social leaders in so many other areas. As this paper will suggest, it is not surprising that verbal indication received by the author of this paper is that the AVCC is reluctant to introduce employee choice of fund, and would opt for limited choice of fund if the present legislative proposals are enacted. Since the cost of unlimited choice of fund would be negligible, and the employing universities would be no worse off in terms of contributions, the refusal to give unlimited choice of fund strongly suggests that there are vested interests in universities at the senior management level.

Choice of investment that many funds such as SSAU have introduced, has simply been an industry tactic to stall choice of fund legislation. There is also a danger that if the limited choice model (which is an option under the current legislative proposals) is introduced, it may be satisfied by investment choice, thereby failing to achieve the competition which is needed in the industry. An important point that opponents of unlimited choice of fund arrangements ignore, is the looming employer and employee liability for economic loses suffered by the employees that they forced into specified funds ie from withholding unlimited freedom of choice of fund.

(1.2) Members are not involved in discussions about their superannuation.

The parties to SSAU's trust deed are the employing universities and the fund's corporate trustee. There is a token SSAU consultative committee (see later), but fund members do not have a real say in the management of their fund. Over the life of SSAU, the consultative committee (a) has met infrequently, (b) has been controlled by employing universities, and (c) has largely been ignored by the trustee. In addition, the awards that introduced compulsory fund membership for university staff were agreed by the employing universities and the relevant unions, even though they represent a minority of relevant employees. Therefore, it is not surprising that fund members are simply not consulted about THEIR superannuation investment of several billion dollars.

The superannuation industry regulator described Australia's system of regulating that industry as "market oriented" and said that monitoring of fund management by members was a "central plank" of the regulatory system. Unfortunately Australia's superannuation legislation does not match the regulatory model. As described in the previous section, since members don't have choice of fund, then the system CANNOT be market oriented. So who is monitoring and regulating Australia's superannuation industry? Since APRA reviews only a very small percentage of superannuation funds, the answer is "No one". Australian superannuation funds are effectively answerable to no-one.

Australia's superannuation legislation does not empower fund members even though member monitoring is a central plank of the regulatory system. In fact s.58 does the opposite. It says that trustees are not subject to direction. Superannuation fund members need to be put in a similar position to company shareholders ie. annual general meeting, direct election of trustees and setting their remuneration, appointing the auditors and hearing their reports, discussing fund performance and management in a forum.

(2.0) Some funds can deliberately sub-optimise members' returns

Given that SSAU has existed since 24.12.1982 and that the deficiencies in the fund have been brought to the attention of relevant parties, it can only be concluded that employing

universities are deliberately sub-optimising the superannuation benefits of thousands of employees. This is evident by the fact that the surplus in the fund would have stood at over $1b. if one third of members had not transferred into the DCP. The Australian Law Reform Commission (1992) expressed the view that a surplus of up to 20% of accrued benefits was acceptable. However, SSAU had the maximum acceptable 20% surplus despite SEVERAL adjustments to members' benefits and the exploitation of the fund as described throughout this paper. What this shows is that the actuarial assumptions underlying the fund were/are extremely conservative. This has the effect of (a) generating a pool of funds for cross subsidisation between members, (b) minimising the chance that the employing universities would have to top up the fund if a deficiency arose,[3] (c) sub-optimising most members' benefits.

(2.1) Low benefit factor

One of the key assumptions (factors) in SSAU is its benefit factor. Each SSAU member's superannuation benefit is defined as [trust deed 1.7.1998, p.60]:

(Benefit salary) x (benefit service) x (lump sum factor) x (average service factor)

In a "normal" situation, this translates into:
(average salary for the last 3 years of employment) x (years of university employment) x (benefit factor). Each year, 21% (ie. .21) of each relevant university employee's salary is contributed to SSAU. The benefit factors in Schedule 2A to the trust deed range from.18 at age 40 or less to .23 at age 65 or more. At age 55 (the minimum retirement age under the trust deed, and for some, under statute), the benefit factor is .21. Effectively this means that if one has derived no salary increase, one simply gets back the contributions made – without any interest. Thus any return on investment for members of SSAU is dependent on salary increases. Members who retire at less than age 55 derive a benefit which is less than the contributions made. While no salary increase over a long period of employment is unlikely, universities have been under pressure for many years, to kerb salary increases[4]. Therefore

[3] Contrary to conventional wisdom about DBPs, employing universities do not guarantee the defined benefit under SSAU's trust deed.
[4] This is true for most university employees but quite the reverse for most senior university employees.

most university employees are deriving extremely low returns on their retirement savings which are compulsorily invested in SSAU.

While the minimum benefit regulations (SISR Div. 5.2) give members of some funds, protection against the above abuse of superannuation, it is still legal to cheat members of defined benefit funds in this way. This abuse is one of the principal reasons that SSAU has such a large (notional) surplus. SSAU has increased the benefit factor several times and provided for temporary supplementary benefits, but still the surplus grows. Clearly this is an indication of how conservatively the actuarial assumptions were and the level of sub-optimisation of most members benefits. It is discussed in detail in Scheiwe (1996).

(2.2) Cross subsidisation

As noted in 2.1, members' return on their equity in SSAU depends on salary increase. Thus those university employees with the highest salary increases near retirement derive substantially higher returns from SSAU than most other members of SSAU. The chief executive officer of SSAU has acknowledged that SSAU was designed for people with concave salary profiles.

The problem in the case of SSAU is that it is a funded defined benefit plan. This means that there is a finite pool of funds from which to pay retirement benefits. Therefore if some members of SSAU are to derive higher returns from SSAU then this must be at the expense of the returns of the other members of the fund. That is, the majority of the fund members will be forced to cross subsidise the superior benefits of the minority (who usually are university senior management). Since SSAU advises that 54.5% of its members are non-academic staff this clearly means that many staff on the lowest incomes of university staff are cross subsidising those on the highest incomes. Because of their design, defined benefit plans effectively assume when calculating retirement benefits, that employees have been on their highest average salary for the entire period of membership of the fund. This means that they assume that both the employee and the employer have always contributed to the fund at the rate applicable to that final average salary. Of course that is not so. Therefore someone must

bear the shortfall in contributions. In funded defined benefit funds such as SSAU, the shortfall is funded by other members. That is, some members must derive sub-optimal returns from the fund in order that other members may derive above average returns. This constitutes cross subsidisation between members.

Thus there are two reasons that the benefit factor has been set so low in SSAU:

(a) to minimise the chance that the employing universities may be called on to top up the fund if a deficiency occurs

(b) to ensure that there is a pool of funds to finance cross subsidisation of higher paid university employees who are members of SSAU, by lower paid university employees who are members of SSAU.

The following are examples of large salary increases of university staff. One can only contemplate the increase in superannuation benefits for the recipients, and the extent of cross subsidisation by those not involved. Superannuation arrangements such as these make a mockery of the SIS benefit protection standards, and the general notion of safeguards in Australia's superannuation regulation.

(1) Interestingly SSAU used to average "benefit salary" over the last 5 years of service, but that was changed at about the same time that one of SSAU's trustees negotiated a substantial salary increase and retired from the university that had employed him in a senior capacity.

(2) It is claimed that one university vice chancellor's salary doubled just before he retired

(3) The media reported that the remuneration of the vice chancellor of Macquarie University increased by some $50,000 p.a. in 1996. Subsequent increases are not known by the author of this paper, but it is understood that all vice chancellors received a 22% salary increase last year.

(4) The remuneration of the vice chancellor of the University of Tasmania increased by at least $55,000 p.a. when he became vice chancellor of the University of Melbourne. Subsequent increases are not known by the author of this paper.

(5) It is claimed that since 1995, the remuneration of the vice chancellor of QUT has increased by 75%. QUT has just entered into a new remuneration agreement with its 123

senior staff. Apart from backdating their ostensibly moderate salary increase several times further than the recent salary increase for other human resources at QUT, the agreement makes provision for bonus payments to senior management. Presumably these also carry superannuation benefits since SSAU's trust deed (p.5) defines "salary" as "... rate of salary or remuneration ..."

(6) It is claimed that the salary package of the vice chancellor of the University of Queensland has now grown to approximately $500,000.

(7) When QUT's most senior female academic became a vice chancellor at another university, affirmative action dictated the appointment of a replacement. Accordingly a woman was appointed professor and dean. She was promoted to senior lecturer in 1996 and professor and dean in 1998 even though it is claimed that many male staff of the university had superior publication records, had served as associate professors or professors, and had (far longer) administrative experience as (acting) heads of school. Thus in two years this woman's remuneration went from mid fifty thousand to approximately triple that amount.

The purpose of mentioning these salary increases is that they (and others like them) involve enormous cross subsidisation within SSAU. Thus it is the recipients of such cross subsidisation who really control the fund and who really make key decisions about its trust deed. For example, less than four months after the last consultative committee meeting, consultative committee members are being asked to approve trust deed changes they have not discussed.

Cross subsidisation within SSAU is further discussed in Scheiwe (1994).

(2.3) Effectively the employing universities are contributing at less than the award rate

Under the relevant award, employing universities contribute 14% of salary to SSAU and employees contribute 7%. Effectively that is not occurring and is condoned by s.117(4) of SIS. This is because, traditionally costs of administering salaries and deductions such as superannuation, were regarded as a cost of employing staff. However, universities have transferred the administration cost of superannuation contributions to SSAU. The transfer of

these administration costs to SSAU can be regarded as an effective reduction in employer contributions below what was agreed in the award.

(3.0) Provision of information to members

Part 2 of SISR prescribes information which must be given to members and others either automatically or on request. However, trustees still have considerable discretion as to what they report. The superannuation industry claims that this amount of mandatory reporting provides considerable protection for fund members.

However, much of the information reported is not understood by members, is meaningless, or is misleading. For example highlighting growth in membership or growth in assets of a fund which members are forced to join says nothing about management performance and is meaningless. It is simply aimed at implying that the fund must be performing well because it is growing. Reporting that a fund achieved its (very low) investment goals is also misleading. Members need information on how their fund (and its performance) compares with the industry's best funds. Unlike shareholders, superannuation fund members do not receive audited financial statements, but rather they receive unaudited abridged financial information, the guidelines for which are non-existent.

Apart from the quality of reporting, there is no point in reporting at all if members are not empowered to act on the reports. The accountancy profession states that the purpose of financial information is to provide information useful to recipients in making and evaluating decisions on the allocation of scarce resources. In the corporate context his means that shareholders receive audited accounts, attend annual general meetings vote out non-performing directors, and if necessary simply sell their shares and invest elsewhere. Superannuants have no such rights. Despite the fact that Australia's system for regulating the superannuation industry is supposed to work that way, the legislation is not written to accommodate it. There is a major mismatch between the system and the legislation.

(3.1) Misleading rate of return reports

The accounting standard for superannuation funds (AAS 25) encourages funds to report their investment return, SISR [(2.29(1)h] requires disclosure of actual or notional rate of fund earnings (presumably that means investment return), and SISR [(2.24(1)g] requires disclosure to individual members (on their benefit statements) of the crediting rate for the reporting year. The problem is that:

(a) in many cases investment rate of return is very different from the rate of return derived by members on their equity in their superannuation fund (because it ignores indirect investing costs and fund operating costs),

(b) investment rate of return is very different from crediting rate because there may be reserving (ie. not all income is allocated to members' accounts)

(c) and crediting rate may also differ considerably from member rate of return because it is quoted pre deduction of the individual's share of fund costs.

Thus quoting/emphasising investment rate of return deliberately encourages members to think that they are deriving that rate of return. In many cases that is not true, and so members are lulled into a false sense of satisfaction with fund performance. This may also lead them to wrongly think that they have adequate superannuation cover. This does not promote achievement of the federal retirement incomes policy objective. Similarly investment rate of return is also misleading because AAS 25 permits the recognition of unrealised gains as income. This is unfair to financial institutions which cannot so recognise unrealised gains as income.

Table 1 overleaf shows (a) SSAU's investment rate of return and (b)) the rate of return derived by several members. Clearly there is a significant gap and therefore it is quite likely that many SSAU members have been significantly misled about the returns they are deriving from the fund. Scheiwe (1997) details how this practice appears to breach the Trade Practices Act and the states' fair trading acts.

The minority of SSAU members who benefit from cross subsidisation, may derive personal returns well in excess of the quoted investment rate of return. However, all SSAU members whose salaries have reached a plateau or are only increasing slightly, are not deriving fair

				A	B	C
Table 1						
r:mem-ror-8						
Member's ROR (version 8)						
	(Prepared by DJS)					
	Fund	SSAU				
	Member's name					
	Year ending	31.12.1998				
1	**Member return from the fund for the year**			DBP/DCP	DBP	DBP
	Closing accumulated benefit			146734.48	124875	46845
	less					
	Opening benefit			134975.28	106556.00	36927
	plus member's contributions		7%	3577.65	3859.45	2844.60
	plus employer's SG contributions			0	0	0
	plus employer's other contributions		14.00%	7155.30	7718.90	5689.20
	less insurance disclosed			0	0	0
	less tax disclosed	15% employer contribution.		1073.30	1157.84	853.38
				144634.94	116976.52	44607.42
	Member return for the year			**2100**	**7898**	**2238**
2	**Member's average equity in the fund**					
	Opening accumulated benefit			134975.28	106556	36927
	plus .5*(employer + employee contributions this year			4829.83	5210.26	3840.21
	less tax & insurance)					
	Member average equity			**139805.11**	**111766.26**	**40767.21**
3	**Member's ROR for the year**	1 divided by 2		1.50%	7.07%	5.49%
4	**Promulgated investment ROR**		1998	12.80%	12.80%	12.80%
	Promulgated crediting rate		1998			
	Relevant fund					
	Notes					
	No insurance disclosed					

returns from SSAU. SSAU has acknowledged that cross subsidisation occurs within the fund but denies that there is SYSTEMATIC cross subsidisation. At one consultative committee meeting, SSAU's chief executive officer even presented a histogram of member returns. This clearly showed a range of member returns and a small minority of members who are deriving far superior returns.

(3.2) Misleading surplus reports

Surpluses can occur in DCPs or DBPs, though most references are to surpluses in DBPs. Despite all the litigation over repatriation of surpluses, SIS still allows them to be repatriated. (s.117). In a DBP a surplus is the excess of the value of fund's net assets over the accrued benefits. Calculation of the surplus depends on numerous actuarial assumptions. The spokesman for the Institute of Chartered Accountants Australia described the manipulation of those assumptions (and hence surplus figures) for the purpose of repatriating surpluses to employers, as "legalised robbery". (Brown, 1992).

When SSAU was first forced into offering a DCP as well as a DBP, the trustees proposed that persons electing to transfer to the DCP would not take their share of the several hundred million dollar surplus at the time. The author of this paper pointed out how outrageous this was and how it represented a breach of trust. The outcome was that persons transferring to the DCP did take their share of the surplus. The author of this paper also asked for assurances that the method of calculating the surplus would not be changed so as to shrink the relevant surplus. That assurance was given by SSAU's CEO. However, note 2a to SSAU's 1997 accounts states :

Change in accounting policy.

> *The financial statements have been prepared on an accruals basis. In previous years they were prepared on an accruals basis with the exception of benefits payable. The financial impact of of this change in policy was to reduce the change in net assets of the scheme by $24.27million in the current financial year.*

This means that the surplus was in fact $24.27m. less than it would have been had the change in accounting policy not been effected and so persons transferring to the DCP obtained a

lower transfer figure than they should have obtained had SSAU honoured its undertaking and abided by the s.52 requirement to act honestly in the interests of all beneficiaries.

(3.3) Misleading employer contribution advertising

Section 2.2 above discussed cross subsidisation within SSAU and section 3.1 above described how the rate of return that most members derive from SSAU is often considerably lower than the promulgated investment rate of return of the fund. When the above practices as misleading and possibly a breach of trust, SSAU's reply was that in DBPs employers contribute a percentage of each employee's salary/remuneration but that is NOT contributed ON BEHALF of the individual employee. It is contributed to a pool from which defined benefits are paid. That MAY be technically correct (according to actuaries), but most members don't see it that way and in fact many are told quite the opposite.

The author of this paper analysed a recent employment advertisement for nearly every Australian university, to determine whether they were saying that the employer superannuation contributions were part of employee remuneration. If SSAU's view of the situation is correct, then universities advertising that employer contributions are part of employee remuneration, are falsely advertising and therefore are in breach of the Trade Practices Act and the states' Fair Trading Acts (see Scheiwe, 1997). Conversely, if SSAU is wrong, employer contributions do belong to employees, and the sub-optimal benefits that many members are deriving from SSAU means that they are not obtaining a fair distribution of the fund's income. Arguably that would constitute a breach of trust.

The employment advertisements were classified as follows:

0 no false advertising

1 mildly false advertising – the remuneration section of the advertisement included reference to superannuation

2 false advertising - the remuneration section of the advertisement included reference to generous superannuation

3 blatantly false advertising – the advertisement specifically stated that employee remuneration included the full 17% employer contribution (14% to SSAU and 3% to TESS).

Table 2 overleaf sets out the findings. Recent advertisements were found for 36 universities. No advertisements were fund for 3 universities. If the SSAU view of employer contributions is accepted, then the advertisements of 28% of advertising universities were blatantly false and overall 53% of universities were advertising falsely. Those universities whose advertisements were not regarded as false were NOT contacted to find out what verbal information was given to inquirers. It should also be pointed out that not all universities had a standard employment advertisement and therefore some advertisements for a particular university may have been false while others may not have been false.

Again based on the SSAU view of employer contributions, the falsely advertising universities are in breach of the Trade Practices Act and the states' Fair Trading acts (See Scheiwe, 1997). Alternatively, the SSAU view of employer contributions is not correct. Obviously one would not expect that universities are the only employers who falsely advertise in this way.

(3.4) Failure to report full trustee fees

In its1998 annual report to members, SSAU did not report trustees' fees. However, administrative fees increased by 50%. Unlike companies, there is no statutory requirement for superannuation funds to report trustees' fees to members and no requirement to consolidate the accounts of the fund, corporate trustee, corporate administrator[5] etc. Consequently, when trustees' fees are reported, one doesn't know whether they are simply the fees from the corporate trustee or from all relevant sources. Another problem associated with accounting (for any entity) is that there is no standard on classification. Accordingly one doesn't know whether trustee or (director) perquisites are accounted for as operating costs or relevant remuneration.

Related party disclosures in SSAU's audited financial statements reveal that certain trustees are on the boards of organisations which SSAU invests in However, most members don't realise that according to an authority on trust law (Marks and Baxt, 1981), the directors' fees of trustees on investee boards by virtue of SSAU's investments, belong to the fund. Verbal

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[5] In fact there is no statutory backing for any accounting standard relevant to superannuation funds, and the audit report gives a lower level of assurance the audit report for a company.

Table 2

	University	Web	False Advert	Pos	Source	Quote
1	Adelaide		0			
2	Canberra		0			
3	Deakin		0			
4	Flinders		0	Lect	A10.11.99p38	Quotes salaries only
5	Flinders		0			
6	Monash		0			
7	QUT		0			
8	RMIT		0			
9	SouthCross		0	Lect	A10.11.99p33	States salary only
10	South Aust		0	Lect	A3.11.99p29	States salary only
11	UNE		0			
12	USQ		0	Various	A10.11.99p39	Quotes salaries only
13	VU		0	Lect	A10.11.99p35	Only salaries quotes
14	W'gong		0			
15	UWS		0		A3.11.99p30	Quotes salaries only
16	Charles Stuart		0	Various	A13.10.99p29	Only salaries quotes
17	USC		0	Various	A3.11.99p23	
18	JCU		1	Various	A27.10.99p40	Salary...Benefits include employer superannuation contribution
19	Macquarie		1	Lect	A27.10.99p35	Salary range $x plus superannuation
20	Sydney		1	Various	A3.11.99p28	A total remuneration ..."Membership of a university superannuation scheme is a condition of employment..."
21	UCQ		1	Lect	A27.10.99p29	Remuneration includes employer superannuation contirubtions and leave loading entitlements
22	Edith Cowan		2	SnHRMan	A27.10.99p37	Salary range: $x plus excellent superannuation provision
23	Tasmania		2	Lect	A3.11.99p24	Salary ranges: $x "Plus excellent superannuation benefits"
24	UTS		2	Lect	A3.11.9p.27	Salary range: $x plus and attractive superannuaiton scheme"
25	UWA		2	SL	A27.10.99p34	Benefits include generous superannuation ...
26	Ballarat		2	Lect	A22.9.99p30	Salary: "Attractive superannuation benefits apply"
27	ANU		3	PDF	A3.11.99p30	Salary: $x "The University contributes an additional 17% of the amount of salary to superannuation"
28	Curtin		3	Lect	A27.10.99p30	The total employkment cost, including superannuation (SSAU) is ...
29	Griffith		3	Various	CM30.10.99p13	Remuneration $x. In addition continuing and fixed term positions of two year or more receive 17% employer contributions
30	LaTrobe		3	Aspro	A27.10.99	The position attracts a remuneration package of ... which includes 17% employer contributions
31	Melbourne		3	Lect	A3.11.9p26	The benefits: $x "plus employer superannuation contribution of 17%

32	Newcastle		3	Various	A27.10.99p39	Benefits: $x Cumpulsory contributory superannuation is a condition of employment plus generous employer contribution of 17%
33	UNSW		3	RA	A3.11.99p24	Total remuneration: $x plus up to 17% employer superannuation..."
34	UNT		3	Aspro	A10.11.99p29	Total remuneration: $x (this figure includes 17% superannuation contribution)
35	UQ		3	Lect	A3.11.99p24	Salary range: $x "plus employer contributions of 17% of salary"
36	Swinburn		3	Various	A13.10.99p35	Salary $x "plus 17% employer contribution to superannuation.
37	ACU		*			
38	Bond		*			
39	Murdoch		*			
40	Notre Dam		*			

information given to the author of this paper is that the significant sums involved are not obtained by SSAU. This and other practices mean that effectively SSAU understates trustees' fees. There is no mechanism in Australia's system for regulating superannuation funds to monitor such situations

(3.5) SSAU generally deals with employers, not members

Because the trust deed represents an agreement between the trustee and employing universities, virtually all negotiations are between those parties and employee/members are left in ignorance despite being the residual owners of the fund. SSAU does have a consultative committee which has met at approximately 2 year intervals in recent years. This is far more frequently than in the first few years of SSAU's existence. However, generally the trustees do not have to consult members and are not subject to direction by it (s.58).

Because retirement benefits from SSAU depend so heavily on final average salary, and because employers control promotions and hence final average salaries, the employer universities largely control SSAU, not the trustees. Consequently those who benefit most from SSAU are senior university management who force employees to be members of SSAU. That is why this paper describes SSAU as an organised crime. Collectively the employer universities are known as the Australian Vice Chancellors' Committee (AVCC).

(4) Investment strategy

Section 52 (2)f requires trustees to formulate and give effect to an investment strategy which takes cognizance of risk, return , and liquidity. This provision is touted as a very important prudential safeguard. However, on the one hand it is quite unenforceable against overly risky investment strategies, and appears to ignore the danger of overly conservative investment strategies. Both are likely to result in very low retirement benefits. Frequently trustees set investment objectives that are so low that they cannot fail to achieve them. Hence such objectives are pointless.

(4.1) SSAU: very low investment goals but far riskier investment strategy

In its 1998 annual report, SSAU notes that "the actuary has calculated that we need rates of return (ROR) 3% greater (after tax) than salary increases…". In view of the protracted wage

restraint for most university employees, this is scarcely an onerous goal. In respect of its DCP, SSAU notes the following gaols for the different investment choices (centre column) and reports the following returns achieved (right hand column):

Table 3

Investment strategy	Target ROR % above CPI	Actual ROR % (ex. tax & fees)
Secure	1	4.7
Stable	2.5	11.3
Trustee selection	4	12.5
Shares	5.5	15.2

Any person can walk into a bank and put money on fixed deposit and achieve the first four target rates of return – free of any risk. Hence one does not need to pay investment managers and bear the cost of a superannuation fund infrastructure to achieve those targets. Therefore the target rates of return show just how low the average benefits are in SSAU and just how easily it can generate a surplus. Given the funding position of many Australian universities it is just a matter of time before this artificial surplus will be repatriated, as it can under s.117 of SIS[6]. That surplus exists primarily because the benefits of most members of SSAU are so low. Despite this, some 50,000 university staff (and all new staff) are compelled to be members of SSAU as a condition of employment! Like everyone else, they need choice of fund legislation.

The table above reports SSAU's investment returns. In recent times SSAU has emphasised that its returns are in the top quartile. Its 1998 annual report notes (p.5) that the above returns were "a satisfying result" and that SSAU is a "long term top quartile performer". What it doesn't emphasise or report is the vastly increased risk exposure of SSAU. Table 4 overleaf shows that in 1988 SSAU had 40% of its investment assets allocated to equities. In recent years that figure has almost doubled and is significantly out of line with the national average for asset allocations. SSAU is now a risky fund. Do SSAU members have adequate prudential safeguard in terms of s.52(2)f? Are the 50,000 members who were not consulted

Table 4

	SSAU	SSAU	SSAU	SSAU	SSAU	SSAU	SSAU	SSAU	SSAU	SSAU	SSAU	SSAU	Nat Av	Nat Av	Nat Av
	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	T'ee select	1994	1996	1998
	%	%	%	%	%	%	%	%	%	%	%	ye 31.3.99?	**	**	**
Aust shares	27	26	27	30	37	40	45	45.4	42.3	41	44.4	%	%	%	%
O'seas shares	13	16	16	30	23	25	25	20.3	23.3	31.9	31	42.5	30	37	46
Total equities	**40**	**42**	**43**	**60**	**60**	**65**	**70**	**65.7**	**65.6**	**72.9**	**75.4**	30	17	15	22
Property etc	26	22	13	20	8	15	15	13.3	12.1	10.6	10.9	**72.5**	**47**	**52**	68
Fixed interest	22	19	16	20	32	20	15	17				15	7	7	4
Cash, S/T deposits	12	17	28									6.5	37	27	25
Bonds												6		5	
Other												0			
								4	22.3	16.5	13.7	0	9	9	3
	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Gain/loss ($'m)*		43.0	-83.2	132.8	-33.1	466.5	-324.0		328.9	509.0	529.4				

* NB value of investment assets increasing

** The grouping does not perfectly correspond

about this strategy happy about it? Clearly this key prudential safeguard is a farce, as reported superannuation fund failures will attest (eg. Griffith, 1998).

(5.0)Trustees

SIS (s.19) practically forces funds to have a corporate trustee because this is a constitutional and regulatory foundation of the relevant federal legislation. However, trustees and funds are accountable to no one. The situation is a travesty of justice.

(5.1) Trustee and fund accountable to no one

SSAU has a corporate trustee Unisuper Ltd. It in turn has a subsidiary Unisuper Management Pty Ltd which is the corporate administrator of SSAU. The shares in Unisuper Ltd are owned by the employing universities and therefore under corporations law, Unisuper Ltd. reports to those universities. The annual general meeting of Unisuper Ltd. receives the auditors report, sets directors' remuneration etc. However, virtually no-body attends those meetings and neither the members of SSAU nor their representatives on the consultative committee receive the accounts, attend the annual general meeting, set director/trustees' remuneration, elect all the director/trustees, etc. Therefore SSAU and its corporate trustee are accountable to no one. For example, SSAU's 1998 summary financial statements revealed that administration costs increased by 50% and other dramatic cost increases have occurred in the past, but there is no mechanism for these to be challenged. There is very limited opportunity even for members of the consultative committee to gain insight into the highly summarised expenditure figures in the accounts, yet on those occasions when insight is possible, extravagance is apparent eg why does SSAU need to rent premium CBD office space in Melbourne? If the consultative committee is expensively entertained how does the board treat itself and senior university staff that they regularly deal with?

(5.2) Equal representation

The basic rule is that there is to be equal representation of employers and employees on the boards of superannuation funds (s.89). Presumably the logic is that having half of the trustees represent the members is better than having no employee representatives on superannuation fund boards ie. the objective was to stop employer domination of funds. As explained above

[6] Since beginning to draft this paper, SSAU has proposed dissipating the surplus to some members of the DBP.

this is clearly a failure. Employers have no legal interest in superannuation funds where they are trusts [7] because they are legally separate entities from the employer. Therefore is it not surprising that the Australian Law Reform Commission stated (1992) that there is no justification for employer representatives on the boards of DCPs and little justification for them on the boards of DBPs. [8] The curious point about employer representatives on trustee boards is that on the one hand they have a duty to act in members' best interests [s.52(2)c] yet they are put on boards as employer representatives! In addition, how can s.52(2)e work? It states that trustees shall "not enter into any contract, or do anything else that would prevent the trustee from, or hinder the trustee in, properly performing or exercising the trustees' functions and powers". The same people cannot always act in the best interests of both employee/members and employer/sponsors.

To avoid deadlocks resulting from equal representation (when trustees are all acting in the best interests of members), trustees can appoint an additional independent chair[9]. In the case of SSAU it has had 2 independent chairs in its 17 year existence. Both of them have been former vice chancellors and employer representatives on the board. Despite that, everyone was expected to believe that they were independent! In addition, if there had been genuine equal representative on the board one would have thought that one of the independent directors would have been a former employee representative.

In addition, the trustees applied to the ISC and was given permission (without any recourse to members) to appoint a second ADDITIONAL director. The appointee was (since the inception of SSAU) an employer representative. Once again everyone is expected to believe that this person will be independent! Personal verbal advice is that both of these men work half time for SSAU (at vastly higher fees than the salaries of SSAU's members). Therefore these two directors have a substantial advantage over other trustees and therefore the asymmetry of knowledge on the board further cements the employers' domination of the fund ie. ensures that the AVCC controls SSAU which, as outlined earlier, operates in favour of senior university staff at the expense of lower paid staff.

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[7] Quinlivan (1994) reported that 94% of superannuation funds are trusts)

[8] See Scheiwe (1997b) for a further discussion on why employers should not be represented on trustee boards.

Based on sheer numbers alone, the ten person board is likely to be dominated by the AVCC because (despite the equal representation rule) only four trustees are employee representatives!

The control of the board by the AVCC is further enhanced by the fact that most of the employer representatives have both financial training and financial experience. In contrast that has not always been the case for employee representatives. They have included a library assistant and a sociologist. At least this situation is (arguably) better than in TESS. In TESS there is no consultative committee and no election of trustees. In SSAU supposedly half of the trustees are elected by the members' elected representatives. In TESS, employee "representatives"[10] are simply union appointees who do not necessarily have any financial skills or knowledge of superannuation. Therefore any debate is likely to be won by the employer representatives, even if the employee representatives genuinely sought act in the best interests of members.

Another reason that the AVCC is likely to dominate SSAU is that until quite recently, there was no provision for election of the employee representatives on SSAU's consultative committee which in turn elects the employee representatives on the SSAU board. In some cases the "employee representatives" were simply senior university staff appointed by the employer. Clearly they were simply additional employer representatives and affected board elections accordingly.

(5.3) Election of trustees open to abuse

S.107 makes provision for the "appointment " of employee representatives, not the election of same. However, SSAU (unlike TESS) does hold "elections" for board positions, but it appears that these elections are in fact run by SSAU itself and therefore there is no independent supervision of the process and no control over incumbents and others using SSAU resources to promote the (re)election of parties willing to refrain from challenging existing policy.

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[9] In the corporate regulatory system this is not imposed on shareholders .

(5.4) Trustees to exercise skill and diligence

S.52(2)b requires that trustees "exercise .... The same degree of skill and diligence as an ordinary prudent person..." . Some 50,000 employee members of SSAU are represented on the board by four people. Verbal information received by the author of this paper is that (a) the employment contract of one of those board representatives was not renewed at its expiry, and (b) another one of those representatives took redundancy from his/her university (c) the director referred to in (a) had only partly completed his circumnavigation of Australia at the time of the last consultative committee meeting (d) that SSAU's trust deed permitted these people to retain their positions on the board until their terms of office expires (e) there are conflicting reports regarding the regularity of attendance of some board members at board and committee meetings. If poor attendance is true then it would be hard to understand how the parties involved were complying with the s.52 requirement of diligence. What mechanism is there for monitoring and dealing with such situations? Normally, the members, the consultative committee, and APRA would not even know about such breaches of the SIS or the complete break down of the equal representation rule. Meeting attendance aside, only 20% of SSAU's board members are university employees who represent the members.

In relation to the requirement to exercise of skill, s.52(2)b implies an objective standard yet anyone can be appointed trustee, even if they do not have ANY financial or superannuation skills. For example, SSAU's board has included a library assistant and a sociologist. Thus once again, the legislation does not match the regulatory system.

(5.5) Act honestly in the interests of (all) beneficiaries

S.52(2)c requires trustees to act in the best interest of the beneficiaries. This means ALL the beneficiaries. Where the cross subsidisation (discussed above) is occurring and trustees are aware of it, how can they be acting in the best interests of [all] the beneficiaries? Thus trustees of funded defined benefit plans cannot act in the best interest of all beneficiaries and therefore cannot comply with s.52(2)c (unless employers make additional contributions to counteract potential cross subsidisation)[11]. Why is this practice permitted to continue if

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[10] The unions represent a small minority of university employees and therefore are not the "representatives" of the majority of relevant employees.

[11] This is discussed in detail in Scheiwe, 1994.

Australia has the effective regulatory system that the industry leads the public to believe they have?

(6.0) Complaints

S.101 requires trustees to establish arrangements to deal with inquiries and complaints. Usually complaints are referred to an independent party. If they could be resolved by the parties involved then a complaint would not continue to exist.

Australia's system for regulation the superannuation industry did set up a Superannuation Complaints Tribunal to which complaints could be referred if the parties involved failed to reach settlement within 90 days. Even from the outset the SCT was a toothless tiger by virtue of ss.14 and 15 of the Superannuation (Resolution of Complaints) Act. These sections limited SCT involvement only to complaints about decisions of the trustee. Therefore, even if members were dissatisfied with the superannuation arrangements that they were forced into either as a condition of employment (eg. SSAU) or by virtue of superannuation guarantee legislation they could not take their complaint to the tribunal. More recently the SCT has been held to be unconstitutional in respect to the power to arbitrate. Thus superannuants are obliged to take the large financial gamble of taking civil action if they are aggrieved. In summary, the federal government forces employees into superannuation funds but does not give them adequate rights and hence does not give them adequate protection.

(6.1) Dissatisfied members are deterred from taking action.

The following are three cases that the author of this paper knows in which SSAU members were dissatisfied, but thought it pointless to pursue the matter further than they did.

(a) One member believed he was disadvantaged in his transfer from SSAU's DBP to its new DCP because relevant mail was sent to the wrong address, even though his benefit statements had recorded his correct address for several years. On advice he rang SSAU and asked to what address his invitation (to change funds) had been sent. He was told that (a) the call was being recorded, and (b) the invitation had been sent to an address he had not lived at for several years. He then asked SSAU to correct its records and send another invitation. Subsequently he noticed that his employing university had the same incorrect residential address in its records. A member of the administration staff admitted that

SSAU had been given and used the employing university's confidential records as the source of its mailing list for invitations to change sub-funds within SSAU. That person later retracted the statement. A verbal complaint was lodged with SSAU which claimed (after the relevant database had been changed) that the invitation had gone to the correct address. Subsequently a written complaint was lodged and SSAU claimed that the invitation had gone to the wrong address because the member had not notified them of the change (even though several years' benefits statements bore the correct address!)

(b) Another member of SSAU complained privately that when he transferred from SSAU's DBP to its DCP he did not receive the benefit which he was told he would receive. He did not pursue the matter as he thought he could not win.

(c) Another member claimed that medical records had been falsified and began supreme court action against SSAU. Eventually he abandoned the action because (i) there was a chance he could lose the reduced benefit he was given, and (ii) the substantial costs involved.

Conclusion

University employees were not consulted regarding the type of fund that should service all Australian universities, were not asked (in many cases) if they wanted to be in SSAU and are forced to remain in it despite the fact that they are being cheated by it. Surely that constitutes an organised crime. It is inconceivable that this is the only Australian superannuation fund where this is happening. Clearly the problems outlined above are grounds for law giving all employees UNLIMITED choice of superannuation fund. In addition, there is a strong argument that relevant employers and unions may be liable in tort for economic losses suffered by employees as a result of being forced into specified superannuation funds. Accordingly it would be in their interests to introduce employee unlimited choice of superannuation fund even if there is no statutory requirement to do so.

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SUPERANNUATION SURVEY

(Appendix to chapter 5)

Thank you for agreeing to complete this questionnaire.
All individual information you give is confidential.
Only aggregated information from all respondents will be disclosed.
In this survey, "receive" means having immediate acess via any of the methods referred to in Q.13 & 14.

In this questionnaire, please circle the letter adjacent to the answer that you choose.
Trustees, investment advisers, actuaries, etc should answer in that capacity, not as members of a particular plan.

Introduction

1 In what capacity are you completing this survey ?
 (a) member of a superannuation plan
 (b) accountant or investment advisor
 (c) actuary
 (d) trustee

2 How many members are there in the superannuation plan to which your answers herein refer?
 (a) 1 to 5
 (b) 6 to 200
 (c) more than 200
 (d) don't know

3 How many times have you been surveyed about the adequacy of the written information you receive from your plan?
 (a) never
 (b) once
 (c) two or three times
 (d) more than three times

4 Are you male or female?
 (a) male
 (b) female

5 What type of superannuation plan do your answers in this survey refer to?
 (a) defined benefit
 (b) defined contribution (ie. accumulation)
 (c) hybrid
 (d) I don't know. (Please name the fund on the next line if this is your answer.)

6 Is your plan run by:
 (a) its own trustee
 (b) the government
 (c) a life office
 (d) don't know

H1a: Do users want to read reports from their superannuation plans?

7 How important is it that you receive written information about the management and performance of your superannuation plan?
 (a) very unimportant. It would be a waste of time and money to provide this information
 (b) unimportant. It wouldn't bother me if I didn't receive any of that information
 (c) undecided
 (d) important. I want to receive at least basic information
 (e) very important. Comprehensive information should be received

8 How much of your plan's SUMMARY financial statements do you read carefully ?

(a) none or a very small amount
(b) a significant amount, but certainly less than half
(c) about half
(d) significantly more than half but not all of them
(e) all of them
(f) not received/ I don't know what summary financial statements are

9 How much of your plan's FULL financial statements do you read ?

(a) none or a very small amount
(b) a significant amount, but certainly less than half
(c) about half
(d) significantly more than half but not all of them
(e) all of them
(f) not received/I don't know what full financial statements are

10 How much of the member/ benefit statement that you receive from your plan do you read ?

(a) none or a very small amount
(b) a significant amount, but certainly less than half
(c) about half
(d) significantly more than half but not all of it
(e) all of it
(f) not received ? I dont' know what a member/ benefit statement is.

H1b: Are users generally satisfied with the reports from their superannuation plans ?

11 How satisfied are you with the nature and amount of written information other than financial statements that you currently receive from your superannuation plan?

(a) very dissatisfied
(b) dissatisfied
(c) undecided
(d) satisfied
(e) very satisfied
(f) no information received

12 Overall, how satisfied are you with the financial statements that you receive from your superannuation plan.

(a) very dissatisfied
(b) dissatisfied
(c) undecided
(d) satisfied
(e) very satisfied
(f) none received

H1c: Reaction to suggestions about general disclosures

13 Please rank in order of priority (1 being highest), your preference re. receipt of FULL financial statements for your superannuation plan. (Please consider this and the next question together.)

( ) I don't want to receive them
( ) automatic receipt in printed form
( ) available on request in printed form
( ) published via a union magazine or similar
( ) available via the internet

14 Please rank in order of priority (1 being highest), your preference re. receipt of SUMMARY financial information for your superannuation plan.

( ) I don't want to receive it
( ) automatic receipt in printed form
( ) available on request in printed form
( ) published via a union magazine or similar
( ) available via the internet

15 The financial reports and all other information which plans lodge with the Australian Prudential Regulation Authority (APRA) should be as publicly accessible as they are for Australian companies & UK and USA superannuation plans.

(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

16 APRA or ASIC (Australian Securities and Investment Commission) should prepare and publish statistics useful to. members in evaluating their superannuation plan's performance and financial condition.

(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

17 Superannuation plans should issue annual reports similar to those of companies.

(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

18 Superannuation plans should have (annual) general meetings with member benefits and functions similar to those of company AGMs. (eg. elect trustees, set trustee remuneration, appoint auditors, hear reports, ask questions, decide on any proposed changes to the trust deed, etc.)

(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

19 Members should receive annually a brief history of their plan.

(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

20 Members should receive annually a summary description of their plan's main features and details of any changes therein.

(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

21 Members should receive an annual summary of significant features of their plan's operations.
(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

22 Members should receive an annual statement regarding their plan's compliance with its trust deed.
(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

23 Is there other general information which members should receive fromtheir superannuation plan eg. relevant ASIC. APRA, and police investigations, prosecutions, litigation, complaints, valid member surveys, etc. (please specify below)?

H2a: Do users want information regarding the basis on which their superannuation reports are prepared ?

24 How important is it that you receive information about the basis on which your plan prepares its reports to members (eg. assumptions) ?
(a) very unimportant. It would be a waste to provide this information to me
(b) unimportant .It wouldn't bother me if I didn't receive any of that information
(c) undecided
(d) important. I'd be upset if I didn't get at least basic information
(e) very important. Comprehensive information should be supplied

H2b: Are users satisfied with the information currently received re the basis of preparing relevant reports?

25 How satisfied are you with the nature and amount of information that you are currently receiving from your plan about the basis on which its reports are prepared?
(a) very dissatisfied
(b) dissatisfied
(c) undecided
(d) satisfied
(e) very satisfied

H2c: Reaction to suggestions about information regarding basis of report preparation.

26 Actuaries should disclose as part of relevant plans' annual reports to members, their major assumptions which affect the plan's financial statements.
(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

27 Like some overseas superannuants, Australian superannuants should receive annually, a justification for changes in actuarial assumptions and methods
- (a) strongly agree
- (b) agree
- (c) undecided
- (d) disagree
- (e) strongly disagree

H3a: Do users want to evaluate their plan's performance.

28 How important is it that you receive information from your plan which will enable you to evaluate its performance
- (a) very unimportant. It would be a waste to provide this information to me
- (b) unimportant .It wouldn't bother me if I didn't receive any of that information
- (c) undecided
- (d) important. I'd be upset if I didn't get at least basic information
- (e) very important. Comprehensive information should be supplied

H3b: Satisfaction with performance evaluation information currently received.

29 How satisfied are you with the nature and amount of information you currently receive from your plan about its performance eg. whether you are likely to receive optimal retirement benefits?
- (a) very dissatisfied
- (b) dissatisfied
- (c) undecided
- (d) satisfied
- (e) very satisfied

30 How satisfied are you with the amount of detail about its assets (including investments) that your plan currently shows in its financial statements?
- (a) very dissatisfied
- (b) dissatisfied
- (c) undecided
- (d) satisfied
- (e) very satisfied

31 How satisfied are you with the amount of detail that your superannuation plan currently provides to members about its investment revenue?
- (a) very dissatisfied
- (b) dissatisfied
- (c) undecided
- (d) satisfied
- (e) very satisfied

32 How satisfied are you with the current amount of disclosure by your superannuation plan about its expenditure?
- (a) very dissatisfied
- (b) dissatisfied
- (c) undecided
- (d) satisfied
- (e) very satisfied

H3c: Reaction to suggestions regarding disclosures about performance.

33 Should members receive from their superannuation plan annually ?
- (a) a summary investment report
- (b) a detailed investment report
- (c) no investment report

34 Plans should disclose annually an evaluation of investment returns relative to risk eg a Jensen Indicator.
- (a) strongly agree
- (b) agree
- (c) undecided
- (d) disagree
- (e) strongly disagree

35 Superannuation plans should disclose details of their investments which are performing poorly eg. less than 90% of the average return for all of their investments.
- (a) strongly agree
- (b) agree
- (c) undecided
- (d) disagree
- (e) strongly disagree

36 Superannuation plans should show in their financial statements as income or losses, changes in the market value of assets, even though most other businesses cannot do so.
- (a) strongly agree
- (b) agree
- (c) undecided
- (d) disagree
- (e) strongly disagree

37 Benefits paid to members should be shown as expenses of the plan, not as reductions in equity or capital.
- (a) strongly agree
- (b) agree
- (c) undecided
- (d) disagree
- (e) strongly disagree

38 To acknowledge that members are the owners of their superannuation plan, superannuation contributions should be recorded as equity or capital added not as revenue or income of the plan.
- (a) strongly agree
- (b) agree
- (c) undecided
- (d) disagree
- (e) strongly disagree

39 Given that contribution lags can legally be over 12 months, plans should separately disclose in their reports, contributions payable by employers for the year but not received by the plan by year end.
- (a) strongly agree
- (b) agree
- (c) undecided
- (d) disagree
- (e) strongly disagree

40 The annual report to members should disclose financial information about the plan, its corporate trustee, corporate administrator, etc. (eg. trustee/director fees paid from ALL of those sources.)
- (a) strongly agree
- (b) agree
- (c) undecided
- (d) disagree
- (e) strongly disagree

41 Members should receive more non financial information from their plans each year eg. how performance and benefits compare with those of the industry's top funds.
- (a) strongly agree
- (b) agree
- (c) undecided
- (d) disagree
- (e) strongly disagree

Other questions on performance disclosure appear later parts of this questionnaire.

H4a: Do users want to evaluate whether management has honoured its fiduciary obligations ?

42 How important is it that you receive from your superannuation plan, information that will enable you to decide whether its managers have acted in your best interests?
- (a) very unimportant. It would be a waste to provide me with this information
- (b) unimportant .It wouldn't bother me if I didn't receive any of that sort of information
- (c) undecided
- (d) important. I'd be upset if I didn't get any relevant information but a simple statement would be enough
- (e) very important. Comprehensive disclosures should be made.

H4b: Are users satisfied with the current fiduciary obligation disclosures ?

43 How satisfied are you with the nature and amount of information that you receive from your superannuation plan about whether management is acting in your best interests?
- (a) very dissatisfied
- (b) dissatisfied
- (c) undecided
- (d) satisfied
- (e) very satisfied

44 How satisfied are you with the nature and amount of information you currently receive from your plan's auditor?
- (a) very dissatisfied
- (b) dissatisfied
- (c) undecided
- (d) satisfied
- (e) very satisfied

H4c: Reaction to suggestions about fiduciary obligation disclosures .

45 Superannuation plans should separately disclose the change in their liability (if any) for trustee and plan employee non-contributory superannuation.?
- (a) strongly agree
- (b) agree
- (c) undecided
- (d) disagree
- (e) strongly disagree

46 Like company directors, trustees should declare in their plan's annual report to members, any direct or indirect interests in contracts made by the superannuation plans for which they act.
(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

47 Plans should disclose their cost of trustee and executive travel and entertainment expenses.
(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

48 Superannuation plans should report separately their fringe benefits tax paid or payable each year.
(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

49 Your superannuation plan is run as well as it could be in the interests of ALL its members.
(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

50 Significant misappropriation (ie. misuse of funds) is probably still occuring in some Australian superannuation plans.
(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

51 Trustees should be required to bring to the attention of members at least annually, any possible unfairness in their plans' trust deeds or their operations.
(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

52 Trustees should advise members at least annually whether all members are deriving the same return on contributions to the plan and if not, what changes to the plan are necessary to achieve that.
(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

H5a: Do users want information about statutory compliance by relevant plans ?

53 How important is it that you are informed annually, whether your plan receives full tax concessions because it complied with applicable law?

(a) very unimportant. It would be a waste to provide me with this information.
(b) unimportant .It wouldn't bother me if I didn't receive any of that sort of information
(c) undecided
(d) important. I'd be upset if I didn't get any relevant information
(e) very important. Comprehensive information should be given.

H5b: User satisfaction with current disclosures about statutory compliance.

54 How satisfied are you with the nature and amount of information you receive from your plan, regarding whether it obtains full tax concessions because it has complied with relevant law?

(a) very dissatisfied
(b) dissatisfied
(c) undecided
(d) satisfied
(e) very satisfied

H5c: Reaction to suggestions regarding disclosures about statutory compliance.

55 Please list below any other disclosures of this nature which you feel should be made.

H6a: Do users want reports that are easily understood?

56 Like their USA counterparts, Australian superannuation plan financial reports to members should be in a style/format that is understandable by average plan members.

(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

57 How important to you is receipt of analyses and projections about the future prospects of your superannuation plan?

(a) very unimportant. It would be a waste to provide me with this information.
(b) unimportant .It wouldn't bother me if I didn't receive any of that sort of information
(c) undecided
(d) important. I'd be upset if I didn't get any relevant information but broad analyses and projections would be enough
(e) very important. Comprehensive analyses and projections should be given.

H6b: Do users understand the Australian superannuation plan reports that they currently receive ?

58 How much of the information (other than financial statements) that you currently receive from your superannuation plan are you confident that you understand ?

(a) very little
(b) a significant amount but less than half
(c) about half
(d) the majority of it but there is a significant amount I don't understand
(e) all or virtually all of it

H7b: Are users satisfied with disclosures about management policies in the current reports of Australian superannuation plans ?

65 How satisfied are you with the amount of information you receive from your plan about its operating policies and changes therein?

(a) very dissatisfied
(b) dissatisfied
(c) undecided
(d) satisfied
(e) very satisfied

66 Are you confident that you know enough about the management of your superannuation plan?

(a) no
(b) undecided
(c) yes

H7c: Reaction to suggestions about (disclosure of) management policies.

67 Plans should disclose to individuals in their benefit statements, the amount that would be their entitlement from reserves (ie. non vested benefits) if the plan were wound up at balance date.

(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

68 Members should decide on the level of any reserves (eg. non-vested benefits) maintained by their plan.

(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

69 Members should participate in setting their plan's investment policy.

(a) strongly agree
(b) agree
(c) undecided
(d) disagree
(e) strongly disagree

70 Please indicate all of the following statements that you AGREE with.

[ ] Employees should be able to choose ANY superannuation fund to be in and be able to change same
[ ] Employees should only have LIMITED CHOICE of superannuation fund to be in eg about 4
[ ] Employees should not have to join a superannuation fund
[ ] Members of superannuation funds should have the choice of at least 3 investment strategies if they are not free to change funds

Please list any other disclosures that superannuation plans should make about changes in their management policies.

CHAPTER 6

RESULTS

Preliminaries

Despite efforts to ensure the maximum response rate, the actual response rate was very low. The final sample size was 76. This size sample is useful as an indication of superannuants, but a larger sample would be preferable as a basis for implementing change.

Introductory items

Ninety six percent of respondents completed the questionnaire in the capacity of a member (Q.1). Fifty six percent of respondents are in plans with more than 200 members and 27% of respondents are in excluded plans Q.2). 87% of respondents had never been surveyed before regarding the adequacy of the written information they receive from their superannuation plan. This supports the assertion earlier in this report, that plan embers were not consulted regarding the content of superannuation plan reports (Q.3). 73% of respondents were male (Q.4), but given the low response rate no analysis of results on the basis of gender will be undertaken in this report. 33% of respondents did not know the type of superannuation plan of which they are a member (Q.5) and 14% did not know broadly, who ran their plan (Q.6). 50% of respondents said that their plan was run by its own trustee.

H1a: Do users want to read reports from their superannuation plans?

49% of respondents said that it is important that they receive **written information** about the management and performance of their superannuation plan, and 36% said it was very important Q.7). Only 13% said that it was unimportant or very unimportant.

43% of respondents said that they read less than half of their plan's **summary financial statements** (Q.8) 7% claimed that they did not receive them or did not know what they are, and 42% claimed to read significantly more than half or all of the summary financial statements.

10% of respondents did not receive **full financial statements** or did not know what they are (Q.10). 30% claimed to read significantly more than half or all of the full financial statements.

If these responses are reliable, then they suggest that the extent to which superannuation plan financial reports are read by members is at least comparable to the extent to which corporation financial reports are read by relevant shareholders (eg see Courtis, 1978)

H1b: Are users generally satisfied with the reports from their superannuation plans?

45% of respondents are satisfied and 23% are very satisfied with the amount of written **information other than financial statements** that they receive from their superannuation plans (Q.11).
55% were satisfied and 18% were very satisfied with the **financial statements** that they receive from their superannuation plans Q.12).

Reaction to suggestions about general disclosures

74% of respondents rated non **receipt of full financial statements** lowest, thus indicating overall, a strong preference for receipt of full financial statements Q.13a).

54% of respondents rated **automatic receipt of full financial statements** in printed form, highest, thus indicating overall a strong preference for this type of reporting, rather than having these reports made available in some other way eg. printed in a union (or similar) magazine, or made available via the internet. (Q.13b)

54% of respondents rated receipt of **full financial statements in printed form only on request,** as second highest, thus corroborating the preference for automatic receipt of full financial statements in printed. (Q.13c)

42% of respondents rated **publication of full financial statements in a union magazine or similar** as their third preference (Q.13d) and 31% rated receipt of full financial statements via the internet as their fourth preference (Q.13e)

Overall, Q.13 indicates that superannuation fund members do want to receive full financial statements. They want these in printed form, ranking publication via the internet as the least popular option. Given that 48% of members read less than half of the full financial statements from their fund (Q.9), the preference for full financial statements may represent a moral hazard.

81% of respondents rated non receipt of **summary financial statements** lowest, thus indicating overall, a strong preference for receipt of summary financial statements Q.14a).

66% of respondents rated automatic receipt of **summary financial statements** in printed form, highest, thus indicating overall a strong preference for this type of reporting, rather than having these reports made available in some other way eg. printed in a union (or similar) magazine, or made available via the internet. (Q.14b)

53% of respondents rated receipt of **summary financial statements** in printed form only on request, as second highest, thus corroborating the preference for automatic receipt of summary financial statements in printed. (Q.14c)

43% of respondents rated publication of **summary financial statements** in a union magazine or similar as their third preference (Q.14d) and 33% rated receipt of summary financial statements via the internet as their fourth preference (Q.14e). Only 6% ranked receipt of summary financial information via the internet as their first preference.

Overall, Q.14 indicates that superannuation fund members do want to receive **summary financial statements**. They want these in printed form, ranking publication via the internet as the least popular option. Given that 43% of members read less than half of

the summary financial statements from their fund (Q.8), the preference for summary financial statements may represent a moral hazard.

44% of respondents strongly agree and 36% agree that **information that plans lodge with APRA should be publicly accessible** as it is for companies and superannuation plans in the UK and USA (Q.15). This suggests that concern about privacy in the superannuation industry may be generated more by plan managers than by plan members.

49% of respondents strongly agree and 36% agree that information **that APRA or ASIC should prepare and publish statistics useful to members in evaluating their plan's performance and financial position.** (Q.16). Again this suggests that concern about privacy in the superannuation industry may be generated more by plan managers than by plan members

34% of respondents strongly agree and 51% agree that **superannuation plans should publish annual reports similar to those of companies** (Q.17). As well as indicating a preference for openness in superannuation plan reporting, this response supports the view that plan members were not (adequately) consulted regarding the reporting requirements in AAS 25 and in SIS.

23% of respondents strongly agree and 44% agree that **superannuation plans should have annual general meetings similar to those of companies** (Q.18). 27% of respondents were undecided about AGMs but only 6% were opposed to them. In this research, AGMs are regarded as an extremely important part of the reporting process, and essential to empowering members to monitor the management and performance of their superannuation plans, as required by the extant regulatory system.

42% of respondents strongly agree and 53% agree that **members should receive annually a brief history of their plan** (Q.19). This is required overseas and could highlight where control of the fund actually resides.

55% of respondents strongly agree and 42% agree that **members should receive annually a summary description of their plan's main features and details of any changes therein.** (Q.20). This could focus on changes in the trust deed, especially changes in benefit entitlements, disposition of surpluses, etc.

43% of respondents strongly agree and 51% agree that **members should receive annually a summary of significant features of their plan's operations.** (Q.21). It could, for example, highlight significant changes and trends in investment policies.

38% of respondents strongly agree and 48% agree that **members should receive an annual statement regarding their plan's compliance with its trust deed.** (Q.22). Whilst it could be said that trustees will not criticise their own performance in such a statement, it does provide positive assurance to members and does make trustees liable for statutory penalties if false declarations are made.

There was no strong demand for additional disclosures in this category and no clear pattern in the suggestions (Q.23).

Conclusion on H1

Respondents said that they are generally satisfied with the reports from their superannuation plans, but their responses to suggestions regarding additional

disclosures (Q.13 to 23) suggested the opposite. They indicated that there is an overwhelming desire for improved general reporting by plans to their members.

H2a: Do users want information regarding the basis on which their superannuation reports are prepared?

11% of respondents indicated that this information is very important and 45% said that it is important. 28% were undecided and 17% thought it was unimportant or very unimportant. (Q.24). An example of information that could be highlighted here is the proportion of the investment return that consists of unrealised gains.

H2b: Are users satisfied with the information currently received regarding the basis of preparing relevant reports?

5% of respondents are very satisfied, 51% are satisfied, 31% are undecided and 13% are dissatisfied or very dissatisfied. (Q.25). These figures need to be compared to the responses to suggestions regarding additional disclosures (Questions 26 and 27).

H2c: Reaction to suggestions about information regarding basis of report preparation.

15% of respondents strongly agreed and 69% agreed that actuaries should disclose **major assumptions** which affect the plan's financial statements. Only 4% disagreed or strongly disagreed with this statement.(Q.26). Examples of assumptions might include: the assumed earning rate of the fund (DBP); the actual benefit ratio (DBP); the average salary increase of plan members; etc.

18% of respondents strongly agreed and 61% agreed that members should receive annually, a **justification for changes in actuarial methods and assumptions**. Only 1% disagreed or strongly disagreed with this statement.(Q.27). These disclosures are required in the USA.

Conclusion on H2

Overall there was strong support for additional disclosures regarding the basis on which superannuation plan reports are prepared. This is despite indicating a high level of satisfaction with relevant reports (Q.11 and Q.12) and the quite low level of reading of those reports (Q.8 and Q.9).

H3a: Users do not want to evaluate their plan's performance

17% of respondents said that it is very important, and 64% said it was important that they receive information that will enable them to evaluate their plan's performance. 12% were undecided and 7% thought this was unimportant or very unimportant. (Q.28)

H3b: Members are not satisfied with the performance evaluation information currently received from their superannuation plans

5% of respondents are very satisfied, 61% are satisfied, 9% are undecided and 24% are dissatisfied or very dissatisfied. (Q.29). These responses need to be compared to responses regarding additional disclosures.

4% of respondents were very satisfied and 53% were satisfied with the amount of detail that plans **disclose in their financial statements regarding their assets**. 18% were dissatisfied and 3% were very dissatisfied (Q.30).

4% of respondents were very satisfied and 47% were satisfied with the amount of detail that **plans provide members regarding their investment revenue**. 22% were dissatisfied and 1% were very dissatisfied (Q.31).

4% of respondents were very satisfied and 34% were satisfied with the amount of detail that plans **disclose in their financial statements regarding their expenditure**. 34% were dissatisfied and 3% were very dissatisfied (Q.32).

H3c: Reactions to suggestions regarding disclosures about performance
65% of respondents believe that that members should receive annually, a summary **investment report**, 32% believe that members should receive a detailed investment report, and 3% believe that members should not receive an investment report (Q.33)

23% of respondents strongly agreed and 53% agreed that members should receive annually, an **evaluation of investment returns relative to risk**. Only 3% disagreed and 0% strongly disagreed with this statement.(Q.34).

28% of respondents strongly agreed and 57% agreed that members should receive annually, **details of investments which are performing poorly**. No one disagreed or strongly disagreed with this statement.(Q.35).

17% of respondents strongly agreed and 49% agreed that superannuation plan financial statements should disclose **changes in market value of assets as income or losses** even though other business cannot do so. Only 7% thought that plans should not make these disclosures (Q.36).

12% of respondents strongly agreed and 38% agreed that **benefits paid to members should be shown as expenses rather than reductions in capital**. 36% of respondees were undecided on this question and 13% thought that they should be treated as reductions in capital (Q.37).

22% of respondents strongly agreed and 49% agreed that **members are the owners of the superannuation plans of which they are members, and that this should be reflected in the relevant financial statements**. Only 4% disagreed and 0% strongly disagreed with this statement.(Q.38).

22% of respondents strongly agreed and 58% agreed that superannuation plan financial statements should show **arrears of employer contributions**. Only 4% disagreed and 0% strongly disagreed with this statement (Q.39).

38% of respondents strongly agreed and 53% agreed that superannuation plan annual reports should disclose information about the plan, its corporate trustee, and its corporate administrator, etc. Only 1% disagreed and 0% strongly disagreed with this statement (Q.40). Basically this question asks whether members want **consolidated accounts for superannuation economic entities.**

26% of respondents strongly agreed and 53% agreed that members should receive **more non-financial information** from their superannuation plans. Only 9% disagreed and 0% strongly disagreed with this statement (Q.41).

Conclusion on H3

Despite initially saying overall that they were satisfied with the performance evaluation information currently received from their superannuation plan, there was very strong support for the additional disclosures suggested. This suggests that respondees may not have considered relevant additional disclosures. It also indicates that it is worthwhile asking members about their disclosure preferences. Many other performance disclosures could have been included in this survey but it was already quite long.

H4a:Members do not want to know whether management has honoured its fiduciary duties

26% of respondents said that it is very important, and 54% said it was important that they receive information that will enable them to decide whether plan managers have acted in their best interests. 9% were undecided and 10% thought this was unimportant or very unimportant. (Q.42)

H4b: Members are satisfied with the current fiduciary obligation disclosures

3% of respondents were very satisfied and 40% were satisfied with the amount of information they receive from the superannuation plans about management honouring its fiduciary duties. 25% were dissatisfied and 1% was very dissatisfied (Q.43).

3% of respondents were very satisfied and 36% were satisfied with the **amount of detail that they receive from their plan's auditor**. 17% were dissatisfied and 1% were very dissatisfied (Q.44). The level of satisfaction is quite surprising given that plans need only supply members automatically, with unaudited summary financial information.

H4c Reactions to suggestions about fiduciary disclosures

16% of respondents strongly agreed and 47% agreed that plans should separately disclose the change in **liability (if any) for trustee and plan employee non-contributory superannuation**. Only 3% disagreed and 0% strongly disagreed with this statement.(Q.45).

33% of respondents strongly agreed and 53% agreed that trustees should declare **any direct or indirect interests in contracts made by the superannuation plans for which they act**. Only 3% disagreed and 0% strongly disagreed with this statement (Q.46). It should be noted that no accounting standards relevant to superannuation plans have statutory backing. Obviously this includes the standard on relate d party disclosures.

39% of respondents strongly agreed and 47% agreed that plans should separately disclose **cost of trustee and executive travel and entertainment**. Only 7% disagreed and 1% strongly disagreed with this statement.(Q.47).

25% of respondents strongly agreed and 52% agreed that plans should separately disclose their **fringe benefits tax payable each year**. Only 8% disagreed and 0% strongly disagreed with this statement.(Q.48).

11% of respondents strongly agreed and 41% agreed that their **superannuation plans are run as well as they can be in the interests of ALL members**. 41% of members were undecided on this issue, 5% disagreed and 1% strongly disagreed with this

statement (Q.49). This question is relevant to cross subsidisation between members within some defined benefit plans.

11% of respondents strongly agreed and 47% agreed that **significant misappropriation is probably still occurring** in some Australian superannuation plans. 39% of members were undecided on this issue, 4% disagreed and 0% strongly disagreed with this statement (Q.50).

26% of respondents strongly agreed and 57% agreed that trustees should be required to bring to the attention of members at least annually, any **possible unfairness in their plan's trust deeds** or their operations. 14% of members were undecided on this issue, 4% disagreed and 0% strongly disagreed with this statement (Q.51).

26% of respondents strongly agreed and 64% agreed that trustees should advise members at least annually, **whether all members are deriving the same return** on contributions to the plan, and if not, what changes are necessary to achieve that. 7% of members were undecided on this issue, 3% disagreed and 1% strongly disagreed with this statement (Q.52).

Conclusions on H4

Respondees clearly indicated that they want information informing them whether trustees have honoured their fiduciary obligations. Just over one quarte were dissatisfied with extant relevant disclosures and just under one fifth were dissatisfied with extant information received from plan auditors. There was very strong support for more detailed disclosure of trustee perquisites and disclosure of instances where members are not being treated equally by their plans. Only 1 in 25 members thought that significant misappropriation is NOT occurring in Australian superannuation plans.

H5a: Do users want information about statutory compliance by their fund?

10% of respondents indicated that **compliance information** is very important and 56% said that it is important. 17% were undecided and 17% thought it was unimportant or very unimportant. (Q.53). An example of information that could be highlighted here is the proportion of the investment return that consists of unrealised gains.

H5b: Are users satisfied with the extant level of relevant disclosures?

4% of respondents indicated that they are very satisfied with the **level of compliance information they currently receive** and 32% said that they are satisfied with the extant disclosures. 40% were undecided and 24% were dissatisfied or very dissatisfied. (Q.54).

Conclusion on H5

Clearly members want this type of information but 50% more members were dissatisfied with extant disclosures than were satisfied. A high proportion of members were undecided as to whether current disclosures are satisfactory.

H6a: Do users want reports that are easily understood?

Predictably, 93% of members felt that **plan reports should be in a form that is easily understood by average plan members**. 4% of respondents were undecided and 3% thought that reports should not be easily understood by average plan members. (Q.56)

15% of respondents said that it is very important, and 56% said it was **important that they receive analyses and projections** about the future prospects of their superannuation plan. 15% were undecided and 14% thought these were unimportant or very unimportant (Q.57).

H6b: Can users understand the non financial reports that they currently receive?
16% of respondents said that they understood all or virtually all of the **non-financial reports** they receive from their superannuation plans. 34% said they understood the majority of it. 12% understood about half of it, and 38% understood less than half of the relevant reports (Q.58).

15% of respondents said that they understood all or virtually all of the **financial reports** they receive from their superannuation plans. 31% said they understood the majority of it. 17% understood about half of it, and 37% understood less than half of the relevant reports (Q.59).

44% of respondents thought that the **average plan member** would understand less than half of the **financial reports** of their superannuation plan. 13% expected that average members would understood about half of the financial reports and 17% said they expected average members to understand more than half of the extant financial reports. 25% had no opinion (Q.60).

30% of respondents said that they were at least dissatisfied with the amount of information that they receive from their plans about its **future prospects** and 40% were at least satisfied with it (Q.61).

H6c: Reactions to suggestions about understandability of superannuation plan reports
15% of respondents strongly agreed and 57% agreed that members should receive **more evaluative information** about plan performance. 19% of members were undecided on this issue, 9% disagreed and no one strongly disagreed with this statement (Q.62).

23% of respondents strongly agreed and 48% agreed that members should **receive more explanation or interpretation** of their plan's financial statements. 20% of members were undecided on this issue, 9% disagreed and no one strongly disagreed with this statement (Q.63).

Conclusion on H6
Respondents clearly indicated a strong desire for easily understandable reports and analyses and interpretations of reports. Half of the respondents could only understand half or less of extant non-financial reports, and 54% understood half or less of the extant financial reports. 57% of respondents thought that average plan members would understand half or less of the reports from their plans. A significant proportion of members were dissatisfied with extant information about their plan 's prospects, but one third more were satisfied with relevant reporting. There was very strong support for the suggestion that members receive more evaluative information about plan performance and more explanation and interpretation of their financial reports.

H7a: Do users of superannuation plan reports want information about management policies of those plans?
18% of respondents indicated that **information about management policies** is very important and 55% said that it is important. 12% were undecided and 15% thought it was unimportant or very unimportant. (Q.64).

H7b: Are users satisfied with extant disclosures about management policies
3% of respondents indicated that they are very satisfied and 28% said that they are satisfied with the **extant disclosures about management policies.** 39% were undecided and 29% were dissatisfied or very dissatisfied. (Q.65).

53% of respondents indicated that they are not confident that they **know enough about the management of their superannuation plan.** 22% were undecided and 24% were confident that they knew enough about the management of their superannuation plan (Q.66).

H7c: Reaction to suggestions about disclosure of management policies
35% of respondents strongly agreed and 46% agreed that **benefit statements should disclose their entitlement from reserves if the plan were wound** up at balance date. 14% of members were undecided on this issue, 4% disagreed and 1% strongly disagreed with this statement (Q.67).

8% of respondents strongly agreed and 36% agreed that **members should decide on the level of reserves maintained by their plan.** 42% were undecided, 12% disagreed and 1% strongly disagreed with this statement (Q.68).

4% of respondents strongly agreed and 29% agreed that **members should participate in setting their plan's investment policy**. 36% of members were undecided on this issue, 26% disagreed and 5% strongly disagreed with this statement (Q.69).

77% of respondents thought that **employees should be able to choose ANY superannuation plan to be in**, and be able to change same. Correspondingly, only 22% thought members should only have limited choice of plans. Only 14% of respondents thought that employees should not be compelled to join a superannuation plan and 68% believed that plan members should have a choice of at least 3 investment strategies with their plan (Q.70).

Conclusions on H7
There was strong desire on the part of plan members for information about it's management policies. While 39% of members were undecided about whether they are receiving a satisfactory amount of relevant information, the proportion of dissatisfied members was almost the same as the proportion of dissatisfied members. Members were strongly in favour of receiving information about notional entitlement to share in reserves, and strong support for the suggestion that members should be involved in setting the level of reserves. While 36% of members were undecided about whether they should participating in investment policy, the proportion of those in favour of this suggestion was almost the same as the proportion of opposed to it. Members are strongly in favour of unlimited choice of fund, strongly in favour of compulsory employee membership of some superannuation fund, and strongly in favour of investment choice within plans.

Chapter conclusion

The findings described above strongly suggest that significant changes are needed in the way superannuation funds report (in the broad sense) to their members. The next chapter sets out relevant recommendations.

Chapter References

Courtis, J., (1978)," Modelling a Financial Ratios Categoric Framework", **Journal of Business Finance and Accounting**, Vol.5 No.4 pp. 371 - 386.

4.7 Recommendations for external reporting by Australian superannuation plans

The following is a list of recommendations:

(a) Annual report

Superannuation plans should be required to prepare and send to members (or make them available via the internet) annual reports similar to those of companies. These should contain:

- a trustees' report (containing the names of the trustees; committee membership and attendance);
- financial reports (with interpretations and projections capable of being understood by the average member; details of asset valuation methods and the persons making relevant valuations; a statement on the truth and fairness of presentation of the financial reports; details of any post balance date events; details of any lag in contributions;
- a traditional audit report (ie. one which expresses an opinion on the truth and fairness of accounts, and is addressed to the members);
- an understandable summary actuarial report (addressed to the members and prepared by the actuary, setting out the major actuarial assumptions, any changes therein, and the impact of any changes made or proposed);
- a plan evaluation including: a brief history of the plan; a brief outline of the plan's benefits and any changes in same during the previous year; a statement by the trustees regarding any possible unfairness which may exist because of the plan's structure or operation; a non financial evaluation of the plan and its performance (in terms of effectiveness, efficiency, and economy;
- an investment report (containing the plan's investment policy, details of new and retired investments during the year and how those changes relate to the investment plan; a measure of overall return relative to risk;
- a fiduciary statement setting out: meeting and recreational use of plan assets by trustees and by staff; trustee and executive remuneration; trustee and executive travel, meeting, conference and entertainment expenses; related party information; fringe benefits tax, superannuation contributions by all entities in the group, on behalf of trustees and executive staff of the plan; gratuities, perquisites, and similar expenses or payments; aggregate sponsorships, research, membership of professional associations, and similar outlays; fees paid to trustees from all entities related to the plan; payments to sponsoring employers.

(b) **Accounting standards**

- All applicable accounting standards should have statutory backing.
- Australia should not adopt the present international accounting standard on superannuation.
- AAS 25 should be revised so that it is consistent with GAAP and the accounting conceptual framework.
- There should be a detailed statutory statement regarding the contents of external reports by Australia superannuation plans (eg. either one similar to AASB 1034, or a statutory-backed accounting standard developed in conjunction with report users)

© **Financial statements**

- Superannuation fund balance sheets should be consistent with the generally accepted accounting for trusts, and not treat members' accrued benefits as liabilities. Instead net assets should be shown as Accumulated Funds, divided into vested benefits and reserves (or non-vested benefits). Assets should be valued at market value but increments and decrements in value should be treated as adjustments to Accumulated Funds (consistent with AAS 10, except that investments should not be treated as inventory, but rather as non-current assets). Trustees should be at liberty to describe changes in market value of assets as determinants of income in the trustees' report to be included in the annual report. Similarly contributions to the plan shall be shown separately in the balance sheet as increases in accumulated funds and payments of benefits should be treated as reductions in Accumulated Funds. Neither contributions nor payments of benefits should be shown in the operating statement (if one is prepared). The balance sheet should have one column for the plan per se and another for the consolidated accounts of the plan, corporate trustee, corporate administrator, and other entities in the group.
- The operating statement (or notes thereto) should show the following separately: income and direct expenses of each category of investment; the rate of return from each category of investment (this could be in the trustees' report and be accompanied by commentary on the effects of changes in market value of assets and a pro-rata allocation of indirect expenses); all trustee related expenses should be shown separately. The information above shall be in addition to the rights of members to seek further information.

(d) **Annual general meetings**

It is recommended that superannuants have unlimited choice of superannuation plan despite the possibility that initially this may cause some difficulties. .In addition to the above, plans should have annual general meetings and members should have the right to call general meetings of members. Such meetings are an important aspect of external reporting. The trustees, auditor, and actuary should attend those meetings, have a right to be heard at them , and answer questions from members. In addition, they should be elected by members (on a rotational basis in the case of trustees). As part of the process of electing the auditor and actuary, tenders may be called prior to the annual general meeting if that was the desire of a previous meeting of members.

4.8 Chapter summary

In this chapter, the extant external reporting requirements of Australian superannuation plans were evaluated on five criteria. Those requirements were found to unsatisfactory on all five criteria. In particular, it was found that the extant external reporting requirements for Australian superannuation plans are:

(a) less onerous than those for Australian companies

(b) less than those prescribed in two relevant overseas accounting pronouncements

© deficient in terms of the statutory requirements of two relevant overseas countries

(d) unsatisfactory in terms of the qualitative characteristics of financial information set out in SAC 3

(e) unsatisfactory in terms of the theory of non-financial performance reporting

Accordingly the external reporting requirements for Australian superannuation plans are considered unsatisfactory and continuation of this research is deemed justified. A list of recommended changes regarding external reporting by Australian superannuation plans was provided.

In the next chapter, the relevant research questions and hypotheses will be developed to test empirically the above findings and to gauge constituent support (or lack thereof) for the

above recommendations.

CONCLUSION AND RECOMMENDATIONS FOR CHANGES IN REPORTING BY AUSTRALIAN SUPERANNUATION PLANS

Conclusion

The objective of financial information is to provide information useful to users in making and evaluating the allocation of scarce resources (SAC 2). While most Australian superannuants do not have choice of fund at present, ultimately that must come if an industry the size of Australia's superannuation industry is to operate optimally. No other Australian industry is permitted the "luxury" of reduced competition resulting from a proper accountability to its stakeholders.

The Australian accounting profession is focussed on reporting by ENTITIES (SAC 2). From the perspective of the proprietors, this is acceptable in businesses because it assumes that favourable performance of the entity will be reflected in increased capital of the proprietors either by direct ownership (eg. unincorporated businesses and proprietary companies) or by increased market price of shares (eg. listed companies).

Those underlying assumptions are not applicable to many superannuation funds, especially defined benefit funds. The performance of the fund may not be reflected in increased accrued benefits of all members. Therefore to focus on returns of the entity as a whole is inappropriate. The focus needs to be on the returns derived by the INDIVIDUAL MEMBER of the fund – because this can be very different from return of the fund. As a result of its focus on reporting entities, the accounting profession, and hence AAS 25 have not addressed this very important point and consequently the extant financial reports on superannuation can be quite misleading. Investment return (which funds encourage members to believe is the return they are deriving from their fund), and crediting rate can be quite different from member's rate of return because neither take into account all of the costs or charges incurred by the fund and passed on to members. This involves widespread deliberate misleading of fund members, and if the accounting profession chooses to ignore the problem by adhering to its narrow focus, then it puts its own credibility in jeopardy. The accounting profession has focussed on the statement of net assets and operating statement of the fund (or the alternative equivalents) and completely ignored benefit statements. In contrast, SIS

(as far it has gone) has "focussed" on benefit statements and largely ignored the detail in fund financial statements.

This anomaly in superannuation reporting is likely to mean less pressure for funds to perform optimally. That coupled with the fact that fund members do not have the same rights as shareholders in regards to annual general meetings. Means that Australia's superannuation industry is undemocratic, possibly unconstitutional, and under performs, with the result that members will derive sub-optimal retirement benefits and the government's retirement income policy will fail. This means increased demands on the public purse for support for an aging population. As widely acknowledged, the consequence of that is substantially increased taxation.

This report will now make recommendations for changes in the way superannuation performance is reported. These recommendations will emphasise the types of information more so than the detailed measures of performance in a bid to avoid the issue reforming superannuation reporting bogging down in detail.

Recommendations

By definition, superannuation plans are intended to provide financially for three contingencies:

(a) retirement
(b) disablement
(c) death.

In respect of each of these, rational superannuants would want to know:

(a) what cover they have at reporting date (currently required)
(b) what cover they should have at reporting date
(c) whether they are deriving optimum benefits from their superannuation plan.

On the one hand it can be argued that provision of the above information is addressing the first element of performance (ie. effectiveness) by seeking to determine whether the plan is achieving the individual's superannuation objectives. On the other hand it could be argued that these information requirements go beyond "mere" financial reporting and begin to impinge on personal financial planning. Encouraging that

seems desirable especially since most superannuants don't have sufficient cover to be financially self sufficient in retirement (Fitzgerald, 1993). **Therefore it is recommended that a blank superannuation needs analysis proforma be included as part of an annual report to members.** These would be used by superannuants either alone or in conjunction with their financial planners, to determine whether they have adequate superannuation cover of each of the three types, in light of their circumstances.

It is grossly unsatisfactory to simply focus on reporting by superannuation plans (in terms of AAS 25) without taking cognisance of the personal reporting needs of superannuants. As in the UK, more attention needs to be given to annual reports and benefit statements in order to ensure that superannuants understand the information reported to them and can determine whether their superannuation benefits are being optimised. This requires more comparative and evaluative information in reports. For example.

(a) is the superannuation plan the report recipient is in, a good one – eg. How does the level of employer contributions compare with other funds?
(b) Is the report recipient deriving a good return from that plan, relative to alternative options – eg. how does the return compare with those of the best funds?
(c) is the return derived good relative to the risk exposure – eg. how does this plan's Jensen (or similar) indicator compare to those of the best funds?

Extant reporting by Australian superannuation plans does not usually provide the information necessary to facilitate those evaluations at an individual level. Therefore **it is recommended that much more comparative/evaluative information be required in superannuation reports.** It is not the accountant's responsibility to report this information, but rather it is the responsibility of the trustees. **It is recommended that a standard annual report format be determined and enforced by law.** Since those reports will reflect on trustees and the superannuation industry, they should not be the only parties involved in determining that report format. Accountants and financial planners should be involved in discussing and determining the mandatory reporting format . In determining that format, the scope for trustees to gild the lily must be minimised. A multi-disciplinary group must work with members in good faith to determine exactly how to report the information that members want,

and the form that they can understand. The reporting must be for the members' benefit, not for the benefit of other parties. For example, reporting investment returns or even crediting rates that significantly differ from rates of return actually derived by members is clear evidence of an industry that is not acting in good faith. **Thus it is recommended that members' individual benefit statements show the actual return that the particular member is deriving from the fund, not the crediting rate or investment return.**

The forgoing focuses on what should be disclosed. Those disclosures are pointless unless fund members have the power to discuss them as a group and rectify what is unsatisfactory. This will necessitate giving superannuants virtually the same powers as shareholders. Therefore **it is recommended that the equal representation rule be abandoned and that superannuation funds hold annual general meetings, at which members elect trustees and set their remuneration, appoint auditors and receive their reports, hear comment from fellow members, and determine broad policy of the fund.** Annual general meetings are a key part of reporting in the broad sense, and therefore it is appropriate that this matter be considered in this report. It is acknowledged that these will not be without their own dangers, particularly in the short term.

The emerging paradigm in superannuation is based on the premise that fund members are the owners of the fund. The present situation regarding accounting for superannuation pans is very unsatisfactory. No relevant accounting standard has statutory backing and AAS 25 is an accounting enigma in terms of its inconsistency with other accounting principles, standards and statements(Scheiwe, 1993). **It is recommended that AAS 25 be substantially revised to give effect to the principle of substance over form and thereby reflect that members are the owners of the superannuation funds of which they are members.** This involves abandoning the entity approach to accounting for superannuation funds with the result that there would be an equity section (sic as "accumulated funds") in relevant statements of financial position, and accrued benefits would be part of accounts such. As part of this revision it is recommended that unrealised gains and losses be treated as capital adjustments, not determinants of "income". **It is also recommended (despite arguments about whether the fund controls the corporate trustee or vice versa)**

that the accounts of each superannuation fund and its associated entities (corporate trustee, corporate administrator etc) be consolidated, with annual financial statements having one column for the fund's accounts and one column for the consolidated accounts. **It is also recommended that all applicable accounting standards (including related party disclosures and AASB 1034) have statutory backing**. Provided that there is agreement on a mandatory standard annual report format, it is recommended that audited financial statements not be sent to members automatically but that they be available via the internet. **Related party disclosures should be a part of the mandatory annual report and the fund auditor should be required to give positive assurance regarding the consistency of the annual report (especially the summarised financial information) with the audited financial statements.**

Whilst not part of reporting per se, **it is recommended that all persons investing in superannuation should have unlimited choice of fund**. This is a logical consequence of the concept that the objective of financial reporting is to provide information useful to users in MAKING and evaluating the ALLOCATIONS OF SCARCE RESOURCES. It is also the only way to make the superannuation industry function optimally.

Implicit in the above recommendation is that the three elements of performance (effectiveness, efficiency and economy) be appropriately addressed in reports to members.

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