

CHAPTER 3

LAW EMPLOYEES SUPERANNUATION FUND

Background

3.1 The Law Employees Superannuation Fund (LESF) is a superannuation fund originally sponsored by the Queensland Law Society for employees in the legal services industry. The trustee of the fund is QLS Superannuation Pty Ltd, whose four directors are two employer directors nominated by the Queensland Law Society on behalf of all contributing employers and two member directors nominated and elected by fund members. As at 30 June 2000, the fund had 5,700 members.

3.2 The fund was originally administered by National Mutual and then Suncorp, before an administration company, LESF Services Pty Ltd, was formed in 1997 to assume that responsibility. The company was wholly owned and controlled by the fund's trustee. One of the then directors of the fund's trustee company, Mr Gerald Parker, was also secretary for the fund through his consulting company Just Consulting Pty Ltd, of which he was the sole director and shareholder.¹ He provided secretary and management services for the fund from 1 July 1997. The Committee was told that there was no tender for this appointment.² Mr Parker resigned as director of the fund's trustee company in December 1998, when the current director Mr Peter Short was appointed. Towards the end of 1999 KPMG and Allen Allen and Hemsley were engaged to investigate the terms of the administration, and subsequently AAS, then an AMP subsidiary, took over administration of the fund from LESF Services Pty Ltd as of 1 May 2000.

3.3 Various concerns about the fund's performance were raised with the Committee. The key concerns raised in evidence by one of the fund members, Mrs Carmel Reading, were:

- the delay before benefit statements and the fund's annual report were sent to members (six months and nine months respectively);
- the fund's poor financial performance in 1998/99; and
- the lack of detail in the trustee's report to members about the fund's poor performance, including the trustee's decision not to reveal information about a defaulting loan on the basis that it might prejudice the borrower.³

1 LESF *Annual Report 1999*, pp. 10-11.

2 Committee Hansard, p. 516.

3 Committee Hansard, p. 491.

3.4 Mrs Reading also complained about the trustee's lack of response to queries from her and other members.⁴

3.5 The Committee was informed that the defaulting loan related to a child care centre at the Gold Coast.⁵ The loan of \$2.5 million was approved by the trustee in mid 1997, the property having been valued at \$3.475 million.⁶ The Committee was told that Mr Parker was also financial advisor to the borrower, although the minutes were said to show he had declared his interest to the other directors and had not voted on the loan proposal.⁷ The Committee noted that in 1998/99 the fund's Direct Mortgage Loan investment decreased from \$3.4 million to \$1.9 million.⁸ The following year the loan was in receivership and had been further devalued to \$1.6 million.⁹ The Committee notes that substantial amounts were allowed in the fund's provision for bad or doubtful debts (\$521,000 in 1998/99 and \$300,000 the following year). LESF's annual report for 1999/2000 noted that the trustee intended 'to eventually sell the property securing the mortgage loan to optimise the return to members' and that the investment was being monitored each month.

3.6 The direct mortgage loan formed part of two of the fund's investment options: its income investment option and its composite investment option. Investment returns for the three years 1997/98 – 1999/2000 showed a large decrease in those two options. In addition, there was a substantial drop in 1998/99 in the equities investment option, as set out in the following table:

Table 3.1: LESF investment returns 1997/98 – 1999/2000¹⁰

Year	Income investment options	Composite investment option	Equities investment options
1997/98	8.62%	15.70%	22.78%
1998/99	0.70%	2.22%	3.73%
1999/2000	1.00%	9.5%	16.0%

4 Committee Hansard, p. 493.

5 Committee Hansard, p. 512.

6 Submission No. 89, p. 1.

7 Committee Hansard, pp. 507-508.

8 LESF *Annual Report 1999*, p. 30.

9 LESF *Annual Report 2000*, p. 21.

10 LESF *Annual Report 2000*, p. 21.

3.7 The Committee was informed that the loan for the child care centre was one of several direct mortgage loans made by the fund in the mid 1990s. In 1998/99, direct loan investments represented 9.5 per cent of the fund's total assets.¹¹ Mr Peter Short, one of the current directors of the trustee company, told the Committee that the fund had made four private mortgage loans and that the other three loans had been repaid.¹² However, the Committee notes media reports that QLS Superannuation Pty Ltd had taken legal action to obtain judgement in respect of another loan which had defaulted, a loan of \$1 million to Club Capricornia Lifestyle Village to buy Clairview Island south of Mackay.¹³

3.8 Mr Short gave evidence to the Committee that he opposed investment by the fund in private mortgages and that on his appointment he had made his position clear to the Board of Directors:

I told the Board that ... even with the very best of systems and checks in place such investments were not in my view appropriate ... because if the Fund was only making 5 or 6 of these loans, then if one of them folded even with the best safeguards it would have a much bigger impact on the Fund that for example if the Fund had hundreds or thousands of these loans ...¹⁴

3.9 Mr Short told the Committee that he had advised the Board he would vigorously oppose such a loan in the future, but that no such situation had since arisen and he did not anticipate it would recur.

3.10 Mr Short also informed the Committee that in 1998 the trustee had selected three financial advisers, BT, Zurich and Macquarie, to manage the fund's low, medium and high risk investments respectively.¹⁵

3.11 The Committee understands that APRA reviewed the fund in early 1999. The two directors of the trustee company who gave evidence to the Committee, Mr Short and Mr Rinaudo, stated that as a result of its review, APRA had given them a list of matters it considered would be 'useful', and that the board had since worked its way through that list.¹⁶ APRA advised the Committee in June 2001 that it was taking no further action in relation to LESF, although ASIC was reviewing some aspects of its past activities.¹⁷

11 LESF *Annual Report 1999*, p. 23.

12 Committee Hansard, p. 507.

13 *The Courier Mail*, 20 March 1999, p. 9. According to the report, Mr Parker confirmed that \$1.148 million had been repaid as full settlement of the debt on 13 January 1998. However, a report in *The Courier Mail*, 26 June 1999 pp. 1, 4, stated that subsequent investors lost \$1.5 million in the same scheme.

14 Committee Hansard, p. 498.

15 Committee Hansard, p. 498.

16 Committee Hansard, p. 519.

17 Committee Hansard, p. 1288.

Issues

3.12 Several issues of concern arose in this case study. The first related to the fund's poor investment performance and, in particular, to the trustee's decisions in the mid 1990s to invest a substantial proportion of the fund's assets in large direct mortgage loans. The fund is still struggling to overcome the results of those decisions. Whether the transactions were at proper 'arm's length', what inquiries were made about the borrowers' ability to repay, whether the trustee sought and obtained independent and credible valuations in all cases and whether a properly formulated investment strategy was in place are all issues that warrant careful consideration by a prudential regulator.

3.13 A second issue concerns the fund's substantial administration fees, in particular the money paid to one of the then directors of the trustee company for managerial services provided to the fund through his private company. It appears that there was no competitive tendering for this appointment, although one of the current directors commented in evidence to the Committee that he believed the company 'did a much better job than the previous administrators had done' and that the administration fee 'was pegged at what the previous administrator was paid'.¹⁸ Nevertheless there appears to have been inadequate disclosure to members of the details of those substantial payments. According to Mr Short, the fund's current administrators AAS:

... say it is difficult to ascertain exactly how the fees paid to Mr Parker to administer the fund were split up. The financial accounts to June 1999 outline an amount of \$502,510 paid to LESF Services Pty Ltd. Of this amount I am unsure how much (if not all) was paid to Gerald Parker himself and how much might be overheads. Further there was a total payment for the same period of \$127,331 for management and secretarial services paid to Just Consulting Pty Ltd in which Mr Parker was (is) a consultant.¹⁹

3.14 Mr Short noted also that in the previous year's annual report, an amount of over \$469,000 was listed as 'other general administration expenses', and that AAS was again unsure how much of that amount may have been paid to Mr Parker.

3.15 Another issue is the extent to which members were provided with comprehensive and timely information about the operation of their fund. The Committee is concerned about the complaints from members that annual reports and members' returns took many months to arrive, and that their queries about the fund's poor performance were not answered to their satisfaction. One member, Mrs Reading, suggested:

18 Committee Hansard, pp. 516-517.

19 Submission No. 89, p. 2.

... there should be an annual meeting of members called where trustees can be called to account, answer questions et cetera, and also inform members of the investment strategies.²⁰

3.16 The current employer-nominated directors gave evidence to the Committee that they had focussed on making the fund's administration more transparent, as well as maximising its security and return to members.²¹

3.17 A further issue concerns the extent to which employee representation on the board of directors of the trustee company provides a real avenue for input by members, for example, into the fund's investment strategy. The requirement for equal representation of employee-elected and employer-appointed directors was based on the premise that employee representation would provide improved accountability to employees. Whether that has been achieved in this case is open to question. The same two employee representatives have been on the board of directors since 1993. Mrs Reading told the Committee she was not aware of the fund's investment strategy or of any suggestion that members might participate in that strategy.²²

3.18 Another issue the Committee was interested to explore was the extent to which employees in the legal services industry had a real choice of superannuation fund. The previous two case studies concerning employees in the hairdressing and hospitality industries demonstrate the possibility that one industry fund that is widely advertised may tend to be regarded as the sole option for prospective members. However, LESF's trustee argued that there was no award requirement for legal employees to pay into any particular fund and that members had a wide choice of funds:

There are no large blocks of employees from particular employers or firms in LESF and the membership appears wide based. Therefore employees and employers in the industry are free and appear to exercise that freedom to choose their choice of fund. Some employers may elect to provide a choice to their employees but some may choose to provide only one option. Some of the large firms may have an EBA [enterprise bargaining agreement] in place that specifies the superannuation fund choices for staff.

... An attraction of LESF is that it was established for the legal services market and the Board is made up of employer and member representatives from the industry.²³

20 Committee Hansard, p. 495.

21 Committee Hansard, p. 518.

22 Committee Hansard, p. 495.

23 Submission No. 89, p. 2.

Conclusion

3.19 The Committee considers that this case study, and in particular LESF's poor financial performance after the trustee's investment in several direct mortgage loans (two of which appear to have ended up in great difficulty), points to the need for more effective supervision by APRA of superannuation funds' investment strategies. This need arises particularly in relation to the smaller to medium sized funds.

3.20 While the Committee cannot comment in detail on the LESF's past financial arrangements, partly because of the incomplete information the Committee received and partly because certain issues are still being examined by ASIC, the Committee is concerned about the lack of detail provided to members about the substantial administration fees. Much of those amounts appear to have been paid to one of the then directors of the trustee company who was providing administrative services. The Committee is concerned that trustees must not only comply with their obligations to conduct financial transactions at 'arm's length' and to act with due diligence, but be seen to be so acting.

3.21 More generally, fund members' concerns about the timeliness and adequacy of information provided to them, either by way of annual reporting or in response to specific requests, need to be addressed.

3.22 Finally, the Committee believes that this case study has pointed to several ongoing issues which may need further consideration in the development of future superannuation policy:

- whether employee representation in a trustee body is effective in providing increased accountability to members of industry-based superannuation funds;
- whether real choice is provided to potential fund members where there is one widely-known industry-specific fund; and
- whether small industry-specific funds with fewer resources should be preferred to larger funds, which have greater resources and hence an increased capacity to pay for expert assistance, such as financial advice, without imposing an undue burden on their members.

Summary of Queensland case studies

3.23 The three case studies in Queensland involve over 36,000 members who have suffered significant losses in terms of negative or very poor returns from their funds over several years. In the case of EPAS, members suffered a negative 43 per cent return in 1998, while members of the Hairdressers Association Superannuation Fund suffered a negative 38 per cent return in 1993. Overall, the Committee considers that the three case studies in Queensland have demonstrated that:

- fees and charges accounted for a disproportionate amount of the administration expenses incurred by two of the three funds, EPAS and LESF, with little

attempt to justify and account for the expenditure (the Committee did not receive any information about the administration expenses for the Hairdressers Association Superannuation Fund);

- there did not appear to be bona fide employee representation (for example, there were no union-elected trustees) in the funds' administration, either because equal representation was not required under the SIS Act²⁴ or because employee representatives may not have been effective;²⁵ and
- the State industrial environment was not conducive to the efficient and effective conduct of the funds, although the Committee notes that the Queensland Government undertook an extensive re-working of the entire industrial system in 1998-1999.

3.24 The Committee considers that these cases highlight the failure of the trustees to discharge their fiduciary duties to the fund members and the failure of the regulatory framework.

3.25 In the Committee's view, the trustees, either through inexperience or lack of knowledge or wilful contravention of their responsibilities, failed in their duty to prudently administer the funds for the long-term benefit of the members. This included allowing investments which appear not to have been at arm's length and which led to poor returns. Some trustees also charged extremely high administrative fees. In some cases it appears they may have exercised inappropriate influence on the operation of the fund and its investment strategy. In particular, the Committee notes that one individual appeared to have significant influence over two of the funds in question, EPAS and the LESF, and that this may have exacerbated the problems common to both funds.

3.26 The Committee also considers that the cases demonstrate serious shortcomings in the oversight of funds. In particular, the Committee considers that:

- the State industrial environment which existed at the time was inadequate and insufficiently vigilant in oversighting the funds and the State Industrial Commission, in naming the funds within the awards did not appear to have developed a strategy to ensure that the funds were operated with integrity;
- the trustees of the funds carried out inappropriate investments;

24 As noted in Chapter 1, the Committee understands that EPAS is a public offer fund and thus is not required under Part 9 of the SIS Act to have equal representation of employees and employers on the trustee body: instead, the trustee must be independent and be approved by the regulator.

25 As noted above in para 3.17, LESF as a standard employer-sponsored fund complied with the equal representation rules, but the Committee had some concerns about the effectiveness of this arrangement given the fund's poor performance. The Committee did not have any further information about the background of the employee representatives. The Committee was also not advised about the status of the Hairdressers Association Superannuation Fund prior to the SIS Act and any employee representation in the fund's first trustees.

- the regulators, APRA and its predecessor, the ISC, were insufficiently vigilant in carrying out their supervisory responsibilities;
- the auditors of the funds appeared to be remiss in the performance of their duties by providing reports which did not obviously highlight the shortcomings of the funds; and
- the employer organisations also appeared to abrogate their responsibilities to their employees by not providing a sufficiently rigorous analysis of the funds which they were endorsing.

3.27 Moreover, the Committee considers that there are probably other funds of a similar nature in Queensland.

3.28 Accordingly, the Committee recommends that, as a matter of urgency in conjunction with APRA, the Queensland State Government, through the Department of Industrial Relations and in consultation with the Queensland Industrial Relations Commission and the Queensland Industrial Court, conduct a review of all superannuation provisions in State awards and agreements with a view to ensuring their consistency with national standards. This review should include:

- identifying and codifying the employer-employee trustee arrangements to ensure that they are genuinely representative of the respective parties;
- identifying fund investment strategies;
- identifying any commissions by funds to any organisations or individuals; and
- identifying existing levels of fees, charges and commissions to determine if there is a significant departure from the industry norm.

3.29 The Committee also recommends that all other State Governments, in conjunction with APRA, conduct similar reviews of superannuation provisions in their State awards and agreements with a view to ensuring their consistency with national standards.

Recommendations

3.30 The Committee recommends that, in conjunction with APRA, the Queensland State Government, through the Department of Industrial Relations and in consultation with the Queensland Industrial Relations Commission and the Queensland Industrial Court, conduct a review of all superannuation provisions in State awards and agreements with a view to ensuring their consistency with national standards.

3.31 The Committee recommends that, in conjunction with APRA, all other State Governments conduct a similar review of all superannuation provisions in their own State awards and agreements with a view to ensuring their consistency with national standards.

3.32 The Committee emphasises that these reviews should particularly address the tests that are applied to superannuation arrangements in industrial awards and agreements, in order to ensure that trustee arrangements are bona fide and that the level of fees and charges conform to appropriate levels.

