



Centre for
**SUPERANNUATION
CONSUMERS**

Submission to:

BETTER REGULATION AND GOVERNANCE, ENHANCED
TRANSPARENCY AND IMPROVED COMPETITION IN SUPERANNUATION

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BETTER REGULATION AND GOVERNANCE, ENHANCED TRANSPARENCY AND IMPROVED COMPETITION IN SUPERANNUATION

There is a saying in the super industry – **super is special** - and we agree with that. Government **policy settings force people to defer their wages** until retirement. While we support this policy objective we think it **creates a very high duty of care towards people’s retirement savings by both government and industry.**

It requires policy settings and analytical capacity that values consumer outcomes and it requires a very high standard of stewardship by industry. Parts of the superannuation industry have been built on ticket clipping and conflicts that have subtracted and destroyed value to consumers – in some cases completely destroyed retirement savings built over a lifetime. More recently there is evidence that the vast super savings pool has become a honey pot for fringe players and fraudsters eg Trio.

This high duty of care requires **a strong regulatory and consumer protection framework and high levels of industry stewardship.** While we welcome the government commitment to no adverse changes to superannuation for this term of government, the system is still evolving as evidenced by this consultation and retirement incomes policy setting will be a large focus of the Financial System Inquiry currently on foot.

Industry voices are loud and numerous, and very well-resourced (due to the very large pool of money amassed from people’s deferred wages) to provide government with research and analysis. Invariably they ask questions from their own perspective, as business operators. Even the not-for-profit funds as they have grown into large businesses, have business interests that may not always be compatible with member outcomes that a consumer organisation would focus on.

However there are times when the industry raises entirely sensible issues, but they have lacked credibility because of the clear vested interests.

Despite the marketing might of this huge and well-resourced industry, consumer trust in it is low. Drivers include volatile returns (especially poor returns), conflicts of interest, policy volatility and costs versus perceived value.

For these reasons we think a consumer-focused technically expert organisation, with capacity to undertake research and analysis and work with government and industry on behalf of consumers is necessary.

About the Superannuation Consumers' Centre

In early 2012 the consumer organisation CHOICE convened an establishment committee for a Superannuation Consumers' Centre. The committee included former Macquarie Bank CEO Allan Moss, Former Vanguard CEO and Financial Services Council Chairman Jeremy Duffield, former ASX and ASIC Chairman Tony D'Aloisio amongst others. In August 2012 the committee took a proposal to Government to provide a one off contribution to an investment fund to provide an endowment to fund the Centre for 20 years. The Government agreed to make a \$10million contribution provided the industry make a matching contribution. While a number of major funds agreed to contribute the committee did not raise the matching \$10million prior to the 2013 election.

Nonetheless the Superannuation Consumers' Centre has established itself as a legal entity, has received ACNC endorsement and is operating on a voluntary basis. The Centre's Board remains of the view that there is a very strong need for a consumer voice in superannuation, especially with the financial system inquiry on foot. Without financial resources it will be very difficult for the Centre's volunteers to undertake sophisticated research and analysis from a consumer perspective to balance the industry voices. The Board continues to explore funding options, many of which require deductible gift recipient status. The Centre will be raising this with Government.

The areas the Centre would like to make an impact on include:

- 1) **accumulation phase** issues including particularly access to quality advice;
- 2) what we call **retirement risk zone** issues ie the issues faced by consumers in the ten year retirement period roughly the five years either side of retirement; and
- 3) the **policy settings and products in the retirement phase**, in particular the need for good default products and quality advice in the transition to retirement and during retirement.

About CHOICE

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia's largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

To find out more about CHOICE's campaign work visit www.choice.com.au/campaigns and to support our campaigns, sign up at www.choice.com.au/campaignsupporter

Part 1: A Better Approach to Regulation

1. The Government has committed to identifying (in dollar terms) measures that offset the cost impost to business of any new regulation. What suggestions do you have for how the regulatory compliance burden can be reduced?

We support the Government's desire to improve regulation and appreciate that it "is mindful that policy changes **must maximise benefits to members**, whilst minimising the compliance burden on the sector."¹

While we support proper consideration of the costs and benefits of regulation via **regulatory impact assessment this must be done within a framework that allows consideration of other factors where RIS methodology is weak**. Key weaknesses are that:

- 1) **Business typically overestimates costs** of regulation and
- 2) The **methodology does not adequately value** (rather than price) **social outcomes**.

¹ P1 Better regulation and governance, enhanced transparency and improved competition in superannuation Discussion Paper 28 November 2013

This means costs to business tend to be inflated and costs to the community undervalued.

US research² “Polluted Data” found cost estimates in advance of regulation were more than twice actual costs in 11 out of 12 cases. Other research “On accuracy of regulatory cost estimates” found costs were 25% higher for 14 out of 28 cases.

Theories³ have been put forward why this might be:

- Technology improves over time bringing costs down
- People get more efficient at implementing new rules over time
- New rules encourage innovation

At the same time as inflating business costs the methodology fails to properly price consumer impacts or intangibles eg the cost of nervous breakdown and health problems following the loss of one’s retirement income following a Storm Financial, Westpoint or Trio, and the cascading problems which follow such as marriage breakdown, spiral into mental health issues, dependency issues and in some cases homelessness.⁴

So we urge the Government to be mindful that history shows us that when it comes to assessing regulatory impacts, costs to business are typically inflated whereas costs to consumers typically undervalued, because they are hard to value and consumer behaviour does not always follow predicted pathways.

We also note that some of the most effective public policy interventions were introduced in the absence of the current RIS processes and we are not confident that they would have survived today’s methodology eg would the succession of smoking reduction measures brought in since the 70s pass RIS methodology? Would section s52 (ban on misleading and deceptive conduct) of the Australian Competition and Consumer Act pass a RIS test?

² Detailed in *Priceless On Knowing the Price of Everything and the Value of Nothing*, Frank Ackerman and Lisa Heinzerling, 2004

³ *ibid*

⁴ For a discussion of the consumer’s experiences post the collapse of Storm Financial see The social impact of financial loss ASIC report 240 May 2011 [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep240-published-May-2011.pdf/\\$file/rep240-published-May-2011.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep240-published-May-2011.pdf/$file/rep240-published-May-2011.pdf)

We think it is critical that the limitations of the RIS methodology are taken into account in assessing any removal of superannuation regulation because superannuation is compulsory.

Government policy settings force people to defer their wages until retirement. While we support this policy objective it creates a very high duty of care towards people's retirement savings and requires a strong regulatory and consumer protection framework.

Part 2: Better Governance

There are two divergent models for superannuation Boards. In general, industry super funds have adopted a stakeholder Board model with one or more independent directors. They do not have executive directors. There is some transparency particularly in the major funds with information about Board members, their date of appointment, committee memberships, governance policies, remuneration and conflict registers available on line⁵.

By contrast little is known about retail fund boards. Few can be found online. Where information is available it is patchy⁶. While it is understood they have in recent times moved to include independent directors little is known about these boards or how they operate, although we understand most have a number of executive directors.

There is a question whether it is appropriate to have any executive directors on a super fund Board given the conflict in interests which can arise between the interests of an executive, which tend to be narrower and favour short term performance, and the stewardship duties of trustees and directors, which tend to be focused on the whole fund and longer term in nature.

We agree that there is an opportunity to bring super fund board practices into line with contemporary best practice corporate governance and we therefore support reform that aligns with the ASX good corporate governance principles⁷. This includes in relation to director, appointment, review and disclosure processes.

⁵ See Who runs CBUS, Board, Committees, Governance, Significant event notices, remuneration <http://www.cbussuper.com.au/about-cbus/fund-governance>

⁶ <http://www.bt.com.au/about-us/trustee-board/>

⁷ http://www.asx.com.au/documents/asx-compliance/cg_principles_recommendations_with_2010_amendments.pdf

One issue that was not raised in the discussion paper is the **size of boards**. Large boards tend to be a feature of stakeholder boards reflecting a desire to accommodate as broad a spread of stakeholders as possible. However there are a number of problems with large Boards:

- Beyond a certain size it is difficult for all members to contribute and so some members become “passengers”
- It is easy for directors to miss meetings and hide under-preparation when boards are large
- Large boards are expensive to run
- There is no evidence that beyond a certain size, generally around seven to 11 that more members add any additional value.

Governance practitioners tend to agree that beyond 11 or 12 directors the above problems tend to emerge. Therefore we think there is an opportunity for some boards to reduce in size, with a generally accepted maximum of 11 or 12.

What should ‘independent’ mean for superannuation fund trustees and directors?

2. What is the most appropriate definition of independence for directors in the context of superannuation boards?

Use of the ASX definition has become widespread in Australian governance generally, including in the not-for-profit sector. It is a simple, clear standard that has proven itself. Additionally it makes sense for APRA to apply the same standard across each of the sectors it supervises.

Proportion and role of independent directors

3. What is an appropriate proportion of independent directors for superannuation boards?

The Cooper review examined this issue and recommended a one third, one third, one third structure for funds that currently have equal representation. Nothing has changed our view in the three years since the Cooper Report was delivered to suggest an alternative approach.

We are not aware of any evidence to suggest that stakeholder boards are ineffective. With rare exceptions it has been our experience across a range of sectors that stakeholder boards in fact work

very well. When comparing performance of super funds there is no evidence that stakeholder board have been detrimental for members, rather funds with stakeholder boards have in fact performed very well.⁸

By contrast recent research⁹ reflecting on the impact of the 2003 ASX rules requiring listed companies to have a majority of independent directors without links to shareholders suggests independent directors have tended to lack relevant industry experience and understanding and have driven dramatic pay increases. The research summary notes:

“The ASX’s rule change is the most costly and disastrous regulatory change ever implemented in Australia by a private regulator.

Pursuit of private interests seems particularly likely for independent directors as, almost by definition, they have small or negligible shareholding or ‘skin in the game’ that diminishes any intrinsic incentive to monitor that the independent director may possess.”

Given the available evidence and that superannuation is a mandatory product, we do not support extension of independent directors beyond one third of any board.

We also think the one third/one third/one third principle should be extended to the retail sector and one third of the Board should be made up of nominees of organisations who have an understanding of the collective consumer experiences in superannuation, for example ageing, welfare and consumer organisations.

4. Both the ASX Principles for listed companies and APRA’s requirements for banking and insurance entities either suggest or require an independent chair. Should superannuation trustee boards have independent chairs?

Yes. Additionally an independent chair is a long standing and important practice for stakeholder boards – see Financial Ombudsman, Food Standards Australia and New Zealand. It is critical that the Chair has the support of all directors and is not aligned to any particular stakeholder group given the role of the Board Chair. We strongly support the concept of an independent Chair.

⁸ There was widespread media coverage of the SuperRatings December 2013 super fund performance review which found at the median the industry fund sector outperformed the median of the retail fund sector over 1, 3, 7 and 10 year

⁹ Does Board Independence Improve Firm Performance? Outcome of a Quasi-Natural Experiment*
Marc-Oliver Fischer† Peter L. Swan‡
Australian School of Business, University of New South Wales
November 18, 2013 available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2312325

Process for appointing directors on superannuation trustee boards

5. Given the way that directors are currently appointed varies across funds, does it matter how independent directors are appointed?

See under Q6 below.

6. Should the process adopted for appointing independent directors be aligned for all board appointments?

The aim of any reforms arising from this process should be to **modernise the governance structures**. Therefore we suggest adopting **current best practice which is to establish a Board nominations committee** which may include external stakeholders to conduct a merit based recruitment process. That is the Board sets criteria for directors and recruits against those criteria. This includes seeking out directors with specific skills from the relevant stakeholder groups.

Rather than having stakeholders appoint directors, **stakeholders can nominate candidates (preferably more than one candidate for each vacancy) who meet set criteria** to the Board nomination committee for **the Board to select the most suitable candidates taking into account the overall needs of the board including group dynamics**.

Whatever processes are adopted they should be transparent and merit-based.

Management of conflicts of interest

7. Are there any other measures that would strengthen the conflict of interest regime?

Consistent with good governance practice super fund boards should maintain a conflict of interest register on its website. Each fund should maintain processes to ensure the register is kept up to date: up to date should mean current as of the most recent meeting.

Boards should have processes in place for ensuring conflicts are declared and managed at every meeting. This is particularly important for retail super boards, which are attached to commercial financial institutions that offer investment products to the market.

In addition the Chair of the Board, CEO and Company Secretary should have responsibility for managing processes where conflicts arise ahead of meetings that would require papers to be withheld from a particular director.

Ongoing effectiveness of superannuation trustee boards

8. In relation to board renewal, should there be maximum appointment terms for directors?

If so, what length of term is appropriate?

Current best practice points to maximum tenure of around nine or ten years. Three terms of three years would meet this standard, though it may be useful to provide a discretion in exceptional circumstances eg where a CEO resigns just before a long standing Chair's term is about to expire. In this situation it would be better to have the flexibility to retain the Chair for an additional year to settle a new CEO in. Any extensions beyond the agreed three terms of three years should be explained publically.

9. Should directors on boards be subject to regular appraisals of their performance?

Yes – this is part of the modernisation package and is consistent with practice in other companies in both the for-profit and not-for-profit sectors. Review can take many forms and Boards should have discretion to choose the most appropriate mode for each review. Reviews should be conducted as a minimum every three years but annually would be appropriate for the first three years after these reforms are introduced. That a review has been undertaken and any significant changes that flow from the review should be reported publically.

Implementation issues

10. Would legislation, an APRA prudential standard, industry self-regulation or a combination be most suitable for implementing changes to governance? What would the regulatory cost and compliance impacts of each option be?

Removal of the requirement for "equal representation" will require legislative amendment. Beyond that we support APRA standards to set out the broad principles or framework of governance requirements and to allow companies to develop governance systems against those standards.

Industry associations may wish to develop detailed guidance to assist their members develop systems and this would be appropriate.

Implementation via APRA standards should allow for practices to flexibly evolve over time. It also allows for innovation in practice, and is least expensive to implement.

11. What is the appropriate timeframe to implement the Government's governance policy under each option?

If the government opts for a one third approach to independent directors, then given trustee terms tend to be three years this would appear a reasonable maximum for implementation, from the time APRA standards are notified. A three year time framework would allow for new directors to be brought on to boards at the same time as retaining the necessary continuity and depth of understanding at Board level.

However if the government opts for a majority of independent directors then a substantially longer implementation timeframe will be required, at least one year for every director that must be replaced. This would be necessary to ensure depth of knowledge and expertise on the boards are retained but also to ensure a good supply of suitable skilled candidates are available for these roles.

12. Given that there will be existing directors appointed under a variety of terms and conditions, what type of transitional rules are required?

We do not see that any transitional rules would be required; rather APRA standards could specify a transition period. APRA could monitor progress through their regular supervisory visits. We believe super fund boards are more than capable of working out a sensible rotation plan once the broad parameters are set.

Part 3: Enhanced transparency—choice product dashboard and portfolio holdings disclosure

Part 3A. Choice product dashboard

13. Should a choice product dashboard present the same information, in the same format, as a MySuper product dashboard? In answering this question you may wish to consider, if the choice product dashboard is to present different information, what should it include and why?

We strongly support the dashboard concept, not only for MySuper but also for choice products. The policy intent is to facilitate comparison and we believe the MySuper dashboard is it very fit for that purpose. **The final form – both the measures and the simplicity - arose from extensive consultation and importantly from consumer testing.** The final measures and simple content were very much influenced by that testing.

Because the intent of the dashboard is to facilitate comparison we support the same dashboard for MySuper and choice products. Consumers will be choosing not only between MySuper products but also between MySuper and choice products. Therefore the content of the dashboards must be the same.

The simplicity of the MySuper dashboard is its key strength and this should be retained for the choice product dashboard.

Net investment return versus net return

14. Is it appropriate to use a single benchmark (CPI plus percentage return) for all choice product return targets?

A single benchmark for simple comparability is appropriate.

15. Should both net investment return (investment return net of investment costs only) and net return (investment return net of all associated costs) be used to measure a product's investment return on the choice product dashboard? In considering this question, you may wish to consider:

- If including an additional measure for a product's investment return would add unnecessary complexity.
- If both net investment return and net return are used on the choice product dashboard, whether they should also be used on the MySuper product dashboard.
- Whether it is appropriate to use a single time horizon, for example 10 years, when calculating target net return and net return for the range of possible choice

products.

We support a **single benchmark** and we support **net return**. We support a **single time horizon**.

More than one return benchmark would introduce a level of complexity that is more likely to confuse consumers and derogate from the usefulness of the dashboard, which is a quick easy comparison tool.

We support using net return because it represents what consumers actually get.

We oppose including net investment return because:

- two measures would be confusing;
- it can obscure the real return to consumers because it does not include the impact of administration fees which vary considerably in cost;
- and is therefore potentially misleading;
- it may inappropriately skew consumer choice towards products that can show a higher investment performance, when in fact the benefits of this may be eroded by higher administrative charges ie the net return to consumers is worse; and
- because net investment return would be higher than net return it could compound problems related to unrealistic performance expectations.

The paper notes the difficulty with net return is that administration fees differ – in our view this is overcome using a representative person – but the fact that administration fees differ is exactly the reason why they should be included. Further disclosures that accurately draw attention to the impact of fees are a critical component of consumer protection in superannuation.

Measuring a product's investment risk

16. Should the choice product dashboard include both a short-term (volatility) and long-term (inflation) risk measure? In considering this question, you may wish to consider:

- **Is the SRM model the best measure of short-term investment risk?**
- **What would be the most suitable measure of long-term risk to include on the product dashboard?**
- **Is it possible to present a long-term risk measure in a similar format to the short-term risk measure (that is High/Medium/Low)?**

- **Would including an additional risk measure add unnecessary complexity to the product dashboard?**

As with return we support simplicity and therefore do not support additional risk measures.

The SRM model has been agreed by the major industry associations and incorporated into the MySuper dashboard and therefore we support its inclusion in the choice dashboard on the basis of consistency. However we note it has limitations (it is complicated by the 20 year time frame, it only describes losses and of unspecified size) therefore think further work should be undertaken to improve on the measure but do not see this as a reason to defer implementation now.

Additional carve outs

17. Are additional carve outs from the choice product dashboard obligations required? If so, why are these additional carve outs required? In considering this question, you may also wish to consider identifying where the gaps in the current carve out provisions are.

The starting point should be blanket coverage and exemptions can be sought on a case by case basis by way of ASIC relief.

A liquidity measure

18. Should a measure of liquidity be included on the choice and/or MySuper product dashboard? If so, what would a suitable measure be?

No. Liquidity is essentially irrelevant for accumulation products. Moreover because standards exist, at best, it would lead to consumer confusion and, at worst, could encourage inappropriate risk adverse behaviour against the interests of consumers.

In addition we do not support inclusion of a liquidity measure for the same reason we do support inclusion of additional measures of return or risk – **the added complexity will confuse consumers and derogate from comprehension and capacity to compare dashboards.**

Implementation issues

19. Should the commencement date for the choice product dashboard be delayed beyond 1 July 2014? If so, what date would be suitable for its commencement? What would be

the benefits and costs to such a delay?

Given the detail may not be settled for another month or two a six month delay to the start date would not be unreasonable, should the industry wish it. However **we are concerned at the lack of alignment with the implementation of the MySuper and the choice dashboard as we see a key choice point for consumers in the next six to 12 months** as MySuper is rolled out being between MySuper products and choice products.

Part 3B. Portfolio holdings disclosure

We support portfolio disclosure holdings in principle. Once resourced, organisations such as ours will be able to make use of this information.

In the meantime the increased transparency will help reveal the layers in product construction eg products like master trusts. This may help sophisticated consumers understand cost drivers in products and at least at the sophisticated end of the market drive demand for simpler products.

It may help protect against what finance specialists call “naïve diversification” – where consumers invest in several different managed funds or similar products, not realizing that they are lead roughly to the same assets.

Some materiality test would protect against information overload.

We do not oppose a one year delay beyond the original implementation.

Part 4: Improved competition in the default superannuation market

We are not commenting on this issue.

An emerging issue

There is one emerging issue that we would like to flag for your attention.

Paying for advice directly from super accounts

We are aware that some funds encourage access to advice by allowing members to pay for financial advice directly from their super account. While we support increased access to advice we have some concerns with this emerging practice. We don't as yet know a lot about the practice but we are aware that that some funds put parameters around this eg they are very clear about what sort of advice may be paid for directly from super accounts, they have quality oversight mechanisms in place and they have upper limits in place, others, however, do not. We would be particularly concerned if ongoing advice is being paid for in this manner.

We have a number of issues with the practice generally.

- 1) We are not at all clear that provision of advice is consistent with the sole purpose test for super.
- 2) We are concerned that payments directly from super assets will not be entirely visible to consumers and could have the same eroding effect on assets as commissions especially where ongoing charges are allowed.

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