Submission to Review into Governance, Efficiency, Structure and Operation of Australia’s Superannuation System

Phase One: Governance

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Phase One: Governance

1. Introduction: accountability by superannuation funds and member sovereignty

The purpose of superannuation is to help Australians save for their retirement, to build their financial security and to ensure the financial independence of the Australian population during their retirement. Members need assurance that superannuation monies are safe and secure over the long term, sufficient incentives are provided to encourage retirement savings, and that government regulation and policies are stable over the long term so it is possible for members to reasonably plan for their retirement. Member sovereignty includes the right to plan for one’s retirement and to hold reasonable expectations concerning one’s assets managed by the superannuation fund. To achieve this, a number of initiatives were recently introduced in Australia, including the licensing of superannuation fund trustees, the introduction of choice of fund, moves to make superannuation more secure as well as plans to simplify and streamline superannuation. If these initiatives are successful, younger Australians will start to plan for their retirement from an earlier age. The current Cooper Review is well motivated to address member sovereignty.

Superannuation has been compulsory in Australia since 1992 with the introduction of the SGC legislation. The superannuation industry metamorphosed from a cottage industry, increasing worker coverage from 32% in 1974 to 92% in 1992, to represent a major part of the financial assets sector. Since 1992, total assets invested by superannuation funds have grown dramatically, and peaked at $1 trillion just prior to the financial crisis. However, as a result of the recent financial crisis, total assets invested by superannuation funds have fallen. Accountability to members in the form of financial reporting has remained largely unchanged.

Like listed entities, superannuation funds access “other people’s money”. The resulting agency relationships create responsibilities and accountabilities from the agent (company/plan trustees) to the principals (shareholders/creditors/members). These
accountability relationships are formalised through a myriad of regulations (for example, the Corporations Act 2001 and the Superannuation Industry (Supervision) Act 1993 (SIS) and Regulations 1994). For listed entities, the Companies Act 2001 requires management to prepare audited financial statements that comply with Australian accounting standards (and that also give a “true and fair” view of the operations of the entity). The audited general purpose financial statements are normally available online from the company’s website, or are available centrally from data managers such as Connect4. Data availability at a central location also permits robust empirical research by academics and researchers. The Australian Securities Exchange also prescribes corporate governance requirements as well as continuous disclosure to encourage a liquid market that is transparent and open.

Unlike listed entities, most superannuation funds are established by a trust deed.¹ Trusts permit duality of “ownership”: that is, the trustee has legal title to the trust property but beneficial ownership rests with the beneficiaries. The trustee is obliged to act in good faith with respect to the management of the trust property on behalf of the beneficiaries. The licensing of trustees was introduced in Australia (that required trustees to be licensed by APRA by 30 June 2006) and has resulted in the trend to larger funds.² However, a pension trust can be distinguished from a normal trust with respect to three factors: first, the member of the superannuation fund is not a volunteer but gives valuable consideration, and unlike a normal trust, is not in receipt of a “bounty” from the settlor of the trust; second, in a normal trust there is usually no other legal relationship between the parties, apart from the trust, whereas in a superannuation trust the employment contract defines the beneficiaries (economic) rights; and third, often membership of the superannuation fund is a condition of employment, and may require the employee make contributions to the fund (Campbell, 2008, p.16).

¹ Other legal forms of pension types include contractual and institutional. The institutional forms operate in Denmark, the Netherlands, Switzerland, Japan and Germany. The OECD supports the institutional form.
² Claims that the trustee licensing system in Australia has resulted in better fund governance and so better outcomes for members is an empirical issue and should be independently tested.
The compulsory nature of superannuation in Australia, the preservation age requirements, the trend towards larger funds, the lack of choice for members of some funds, the minimal accountability by fund trustees to members and financial literacy issues contribute to a less than liquid superannuation market in Australia. Accountability and transparency by those in control of “other people’s money” to the “other people” (or stakeholders) is fundamental to good corporate/fund governance. The Cadbury report identifies three core principles of corporate governance, that is, openness, accountability and integrity. This submission will focus on the role of accountability and the perceived lack of “intelligent accountability” or active inquiry (O’Neill, 2002) for superannuation fund members in Australia. The lack of publicly available superannuation plan financial data (from a central location) means that robust and independent research into fund reporting by academics in particular is stifled.

2. Accountability to members

5.4.1 Accountability to members: Are super funds, individually or as a class, sufficiently accountable to members? How successful has the policy committee structure (Part 9 of the SIS Act) been? Do superfund members need a body or association that just represents them and advocates their issues? Should larger funds host, for example, online AGMs?

(i) Whole-of-fund accountability to users of superannuation plans

As stated above, most superannuation funds in Australia are trusts, where the superannuation assets are held in trust by the plan trustee for the benefit of the members. The trustee is accountable to the members to show how the assets have been managed and disbursed (the trustee’s duties are set out in the Superannuation Industry (Supervision) Act 1993 (SIS) and regulations). This is the stewardship function of

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accounting that focuses on showing the member how the assets of the superannuation fund have been invested by the trustee, the return on the investments and the fees and costs incurred. Generally, this information is backward looking. On the other hand, international accounting standard-setters now centre on the decision usefulness of financial information and emphasise the relevance of financial information to enable users to make resource allocation decisions. For example, superannuation funds are required to prepare (whole-of-fund) general purpose financial statements (see AAS 25 Financial Reporting by Superannuation Funds and ED 179 Superannuation Plans and Approved Deposit Funds). ED 179 paragraph 1 states that the objective of the standard is to specify requirements for general purpose financial reporting by superannuation funds to provide users with information that is useful for their decision-making. For example, the AASB in ED 179 Basis for Conclusions considers employer-sponsors (normally regarded as preparers) as users of financial statements of superannuation funds.

Decision usefulness of financial information enables users to use the information as inputs into their predictive processes to either revise old expectations or produce entirely different scenarios for the future (that is, forward looking). From the point of view of the member of a superannuation fund, both accountability and decision usefulness are relevant, although decision usefulness is less relevant if members do not have choice of fund, lack easy access to superannuation fund accounts that are also comparable, and lack understandability of product disclosure statements due to financial literacy concerns. It is also important that the principal accountability relationship of a superannuation fund with its members remains at the forefront of financial reporting by superannuation plans so that member beneficiaries retain their rights of sovereignty. ED 179 is unclear whether it is aimed at assisting decision making by the member or employer or some other user group. Nonetheless, the presentation of whole-of-fund accounts in this way is extremely important to informed members.

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4 The Australian Accounting Standards Board imposes reporting requirements upon reporting entities (if users exist who are unable to command their own information needs). As new accounting standards are developed, a due process is followed so that preparers, stakeholders such as shareholders, and other interested parties (including industry bodies, regulators and academics) of the financial statements are given the opportunity to lobby their reporting preferences.
The normal practice of industry superannuation funds is to forward copies of the audited financial statements of the plan only upon written request by a member. This is the regulatory minimum. I visited the websites of a number of larger funds and was unable to locate the audited financial statements of the superannuation plan. It is possible that the audited financial statements may be available through the member login. However, it is common for funds to state in the Annual Report to members (see section (ii) below) that the audited financial statements are available upon written request by the member, which suggests a reluctance by superannuation funds to make their audited financial statements available online. It also suggests the superannuation funds, especially the very large superannuation plans, are reluctant to recognise that they are a reporting entity (see preface to ED 179 Superannuation Plans and Approved Deposit Funds, p.7) and therefore their full audited financial statements should be publicly available on their website (similar to a listed entity). Further, given the choice of fund legislation, it is reasonable that the superannuation plan’s audited financial statements prepared in accordance with Australian accounting standards that incorporate IFRS, should be publicly available online.

It is now untenable for superannuation plan administrators to maintain that disclosure of information to members will only “confuse” or it is too “costly”. The argument that the average member does not understand the audited financial statements of a superannuation plan is similar to stating that “only the high priests understand Latin”. After all, most superannuation members hold indirect interests in the share market through their superannuation and would probably be more aware of market economics due to this (especially in the period where mass media publicise daily changes in underlying economic parameters and relate these back to the share and bond markets). One of the lessons of the recent financial crisis is the poor communication of risk by the financial services industry to retail investors. Several local Australian councils were burnt because there was inadequate disclosure by intermediaries of what basic assets supported complex financial instruments such as collateralised debt obligations.
The link between the complexity of the product and the commission demanded by intermediaries also needs to be looked at. Defending non-disclosure on the grounds that the “wizardry” of the transaction is too complicated for the layman to understand and justifying handsome commissions on this basis needs revision. It is acknowledged that explaining the technicalities as well as the risk outcomes of financial transactions may be challenging, but the medical profession has faced similar issues and sought solutions (see Pension investors fail to get the message, Financial Times, 27 July 2009, p.3). The legal profession is also tackling problems with the lack of clarity in Judges’ decisions (Judges learn to make sentences less cryptic, The AFR, 9 October 2009, p. 44).

Recommendations:

- The audited general purpose financial statements for superannuation plans that are reporting entities should be available to the public on the plan’s website. The general purpose financial statements should be prepared in accordance with Australian accounting standards including IFRS and be accompanied by the auditor’s report. (Note that the auditor’s report is addressed to the trustees and the members).

- Mandatory rotation of the external auditor (similar to the CLERP9 requirements for listed entities)

(ii) Annual Report and Abridged Financial Statements

Abridged financial statements with a statement by the auditor are included in the annual reports of the superannuation plans and are normally available online. Generally, the abridged financial statements would not exceed one A4 page in length and do not include any disclosures, disaggregation or explanations of the numbers. They comprise a statement of changes in net assets (typically 12-15 lines) and a statement of net assets (typically 12-15 lines). There is no statement of cash flow. The statement by the auditor (attached to the abridged financial statements) is very brief and normally states that the abridged financial statements are prepared in accordance with/consistent with the plans’ financial statements, and usually comments on the type of audit opinion issued.
financial information provided by the superannuation plans in their annual reports is generally negligible and only satisfies the regulatory minimum.

Annual reports also include extensive marketing material by the plan that is unaudited. A review of some of the online annual reports of superannuation plans suggests, in my opinion, that it is fulfilling more a marketing exercise than an accountability function to members. For example, one fund presented abridged financial statements that were based on unaudited figures for 2009.

Recommendation:

- Given that superannuation is compulsory in Australia, there should be more stringent industry guidelines regarding the content of annual reports to members. They should not be used as marketing tools.
- The format and content of the abridged financial statements should be reviewed in a way that emphasises understandability to members.
- The external auditor should conduct a review of the annual report to ensure that the qualitative disclosures in the annual report are consistent with the abridged financial statements.
- A separate body to represent members (similar to the Shareholders’ Association) should be established. The member’s body should be able to, aside from being the members’ advocate, circularise feedback forms to members of selected superannuation funds to gauge member satisfaction and highlight issues worthy of trustee attention in the future. The trustees should be required to submit a report to the members’ representative body based on this feedback from members detailing action taken by the trustees. This process should be documented with all reports published on the web for members to review. For example, members may want their fund to spend more resources on member education. The establishment of a separate member body will ensure that this issue is addressed from the members’ point of view (and not from the perspective of those bodies that advocate non-disclosure to members).
• The members’ representative body should be independent from the trustees of the superannuation funds. For example, current or former trustees should be ineligible to represent the members.

• The members’ representative body should be financially funded by the superannuation plans, similar to the way the superannuation industry so generously financially supports associations to support trustee activities.

• An AGM should be held each year such that members are able to raise issues and make inquiries of the board of trustees regarding their decisions. The establishment of a members’ representative body would be able to issue policy statements on best practice and to monitor this process, as well as consider the merits of an online AGM for member access to the board of trustees.

(iii) Individual member balances

Members receive (usually bi-annual) statements about their individual superannuation balances that show, for the defined contribution member, their opening balance, aggregate movements through the year (contributions, fees and costs) and the closing balance. Most superannuation fund websites have a member login. The effect of the recent financial crisis has been keenly felt by defined contribution superannuation members as their superannuation balances have tumbled. On the other hand, for defined benefit plans, members receive advice about their total opening and closing balances but there is not a separate account maintained for each member as in a defined contribution plan because the DB assets are pooled. However, in Australia, the defined benefit “guarantee” is uncertain when compared to the USA or the UK. This diminishes the distinction between defined benefit and defined contribution funds in the Australian context.

It is not always clear to the individual member the composition of, and how, the total fees, costs and charges of the plan are allocated across members. There should be a reconciliation of total fees, costs and charges as per the audited financial statements to the
amounts allocated to member accounts. It is essential to keep the costs of superannuation plans low and to increase the transparency surrounding these costs. This is particularly so as recent events (the financial crisis) reveal that high fees were frequently unrelated to performance and that the real beneficiaries were not the members but the intermediaries.

**Recommendation:**

- Reconciliations of total fees and charges as per the audited financial statements to the amounts allocated to individual member balances should be disclosed to members

(iv) Employee representation on the trust board and the consultative committee

Some superannuation funds have a consultative committee that is meant to act as a conduit between trustees and the members. However, it is not unusual for members not to know their representative on the consultative committee. As well as a lack of communication to members, there is often a lack of documentation of the activities of the consultative committee to the members.

**Recommendation:**

- there should be a procedure where the member is able to submit in writing matters of concern to their consultative committee member to be tabled at the next meeting of trustees; this tabling at the next meeting of trustees should be documented and result in a written response to the member; and with the entire process as well as the outcome of the member’s query being publicised on the website for all members to see.
- Consultative committee members and the employee representatives on the board of trustees should have a maximum term of office of three years.
- Superannuation plans also have member complaint resolution procedures. Details of type, number and outcome of member complaints should be published on the superannuation plan’s website on an ongoing basis so that all members are fully informed.
(v) Information on the Superannuation Fund Website

Given that superannuation is compulsory in Australia, and that in the long term, funds under management are predicted to grow in the future, it is important that information circulated to members is not biased. A random review of the websites of some superannuation plans shows a strong emphasis on constructing a positive image of the plan and its operations, even during a financial crisis. There do not appear to be industry reporting standards regarding the presentation of financial and non-financial information on the website (that may influence a member’s decision making activities). It is not unusual for several superannuation plans to claim that they have low fees but with no evidence of this claim, and no basis of comparison to other like funds. One superannuation plan presented a negative investment performance for the 2009 year as positive information by stating that the members of the plan, compared to members in other superannuation plans, were better off by x%. These are spurious claims with no justification. In addition, there are numerous industry prizes that are awarded to superannuation plans but the merit of each award is difficult to decipher when comparing the superannuation plan operations from one fund to the next. In my opinion, there are not sufficient disclosures as to the basis (or meaningfulness) of the award donor and the nature of the business relationship that the donor has with the superannuation industry.

Recommendation:

- Given that superannuation is compulsory in Australia, the websites of superannuation plans should follow stringent guidelines that downplay marketing and instead, follow “best practice” focused on informing the member.

- The superannuation plan’s website is a valuable medium whose potential has not been fully realised from an “accountability to members” point of view. For example, and referring to some of the recommendations made above, the audited general purpose financial statements, the auditors’ report, governance procedures with respect to the (recommended) members’
representative body, (recommended) governance procedures with respect to the consultative committee and member complaints procedures and other governance and educational material should be published on superannuation fund websites.

Compared to listed entities, there is minimal regulation of the reporting of both financial and non-financial information by superannuation plans to members. As a result, agency costs are not reduced and opportunities for “intelligent accountability” by the members are absent. Under these circumstances, in my opinion, member sovereignty is difficult to obtain.

3. Corporate and Fund Governance: investment type

5.4.2 Corporate governance of underlying investments: There is currently no formal connection between the views of super fund members and the exercise of votes on equity investments held by the fund. As members of superannuation funds are collectively substantial owners of capital, should they have a say on who represents their interests in corporate board rooms? How could this be achieved?

There is a disconnect between the fiduciary rights of members and the exercise of judgement by members with respect to this fiduciary right as far as the superannuation plan is concerned. Therefore it is difficult to see how members’ rights would be represented “twice removed” when the reduction in agency costs is not occurring “once removed” at the superannuation level.

5.4.3 Responsibility for investments: How do superannuation trustees decide what choices to offer members? How much responsibility should be placed on trustees for individual investment strategies when members make investment choices either with or without separate advice? Is it appropriate to allow fund members to direct a trustee to follow any investment strategy a member chooses from the trustee’s available investment options?
While Australia’s superannuation system may sometimes be applauded overseas because it achieves retirement savings through the 9% SGC, it should be remembered that most of the superannuation plans in Australia are defined contribution. That means that we are yet to experience how a nation of members will manage their investment risk so that the next generation is not over-taxed. It is not in the economy’s interest for any group (including plan trustees) to be given (absolute) free reign of super monies. In Australia, superannuation represents deferred pay, not a managerial gratuity, so individual freedom of choice must be respected and more resources devoted to member education (rather than reliance on financial advisers).

Pablo Antolin (Chief Economist OECD’s private pensions and financial affairs division) favours a default pension plan with a life annuity indexed to inflation for defined contribution plans.

**Recommendation:**

- **More financial resources should be devoted to educating the general public and members about superannuation rather than relying on financial advisers.** While it is recognised this is a long-term task, introducing superannuation (and the benefits of compound interest) as a compulsory part of the school curriculum could be considered.