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### **Better Regulation and Governance, Enhanced Transparency and Improved Competition in Superannuation**

The SMSF Owners' Alliance takes an interest in the good governance and transparency of APRA-regulated funds first because some SMSFs invest in pooled funds and secondly because we want to see a thriving and well managed superannuation sector in Australia.

SMSFOA does not have the resources to answer all of the 31 focus questions in the Discussion Paper issued by Treasury. Instead, we cover some key points.

#### **1. Why SMSFOA is interested in the governance of APRA-regulated funds**

ATO superannuation statistics show that in June 2013, SMSFs held an estimated \$18.7 billion in 'other managed investments'. The number of SMSFs with 'other managed investments' was 61,680 with an average investment of \$327,811.

The 'other managed investments' category includes APRA-regulated funds. Although the ATO advise us that they do not collect further data on the types of investment covered in this category, it is fair to assume that a significant proportion of SMSF investment in 'other managed investments' is invested in APRA-regulated funds.

So it can be seen that SMSFs are significant stakeholders in APRA-regulated funds and it is therefore in their interests for these funds to be well managed and to adhere to high standards of governance and transparency.

It is also in the interests of SMSFs to have access to comprehensive information on the governance and performance of APRA-regulated funds. In particular, financial planners and other advisers to SMSFs need access to such information so they can confidently advise their SMSF clients on managed investments as one of the options open to them.

This information needs to be more comprehensive than the standard Dashboard menu developed for the MySuper reforms which provides fairly elementary information which may be useful for the ordinary person making a choice of fund but may not be sufficient for SMSF trustees to make a well informed investment decision.

## **2. Why high standards of governance and transparency should apply to APRA-regulated funds**

The requirement for high standards of governance and transparency for APRA-regulated funds stems from their role as trustees of some \$970 billion in retirement savings held in 28.8 million member accounts. This can be compared with the \$643 billion deposited in banks by Australian households.

Some APRA-regulated superannuation funds are very large businesses in their own right, for example AustralianSuper has funds under management of more than \$60 billion.

The prudential supervision of APRA-regulated funds should be as stringent as APRA's supervision of banks and the governance standards of funds should be comparable to the governance standards required of banks and other large corporations.

We acknowledge that some leading APRA-regulated funds already provide a high level of disclosure of fund performance to members and the market at large via their annual reports and websites.

However, information on the governance of the trustee companies that manage the funds and the financial arrangements between the trustee companies and the funds is not made so readily and publicly available.

In our view, trustee companies should be required to meet equivalent standards of governance and disclosure as are required of public companies under the Corporations Act and the ASX Corporate Governance Principles and Recommendations. The principles embodied in corporate law and the ASX guidelines are relevant to APRA-regulated funds though their application may not be appropriate in all respects, given their different legal structure.

While we would not go so far as to suggest that APRA-regulated funds should be required to hold annual meetings of members with financial accounts being presented for discussion, as public companies must do, they should be encouraged to provide an opportunity for members to question trustee company directors about investment strategy, the performance of the fund, costs allocated to members, the governance structure, the appointment of trustees and any other issues pertaining to the fund. This might be in the form of an annual member forum or other public inter-active format.

## **3. Why SMSFs are different**

In contrast to APRA regulated funds, there is no corresponding issue of trust for SMSFs as the trustees and beneficiaries of these funds are the same people. This distinction was well made in the final report of the Super System Review in 2010 which noted the emphasis on prudential regulation by APRA of pooled superannuation funds while for self-managed funds the regulatory focus by the ATO is on tax compliance. The Discussion Paper also acknowledges that SMSFs are fundamentally different and are therefore not included in the proposed reforms.

#### **4. Independence of trustee company boards**

Some industry funds have equal representation on their boards of directors nominated by employer and employee sponsors with these arrangements covered by the Superannuation Industry Supervision (SIS) Act. As the Discussion Paper notes, this reflects the early development of industry funds in specific sectors. However, many Industry funds have since opened up to a wider range of members beyond employees in the industry sector covered by the fund. APRA reports that in 2013, the majority (58%) of registered superannuation entities were licensed as public offer funds with 85% of the assets of all registered funds.

As most industry funds now compete directly with retail funds for members and a larger share of the nation's superannuation savings, it is appropriate and necessary for at least a majority of the trustee company boards of public offer funds to be independent.

Independent trustees are better placed to make objective decisions in the interests of all fund members and conflicts of interest are likely to arise less often and be more effectively managed.

Independent directors also bring to the trustee company board the benefit of their experience in wider fields of expertise, including business, finance and public administration.

Section 10(1) of the SIS Act defines an independent director as a director who is not a member of the fund; is not an employer or employee sponsor or an associate of either; and is not in any capacity a member of a trade union or an employer representative. As the Discussion Paper notes, this does not prevent someone who has an existing or former relationship with a fund, either as a service provider or former employee, from being regarded as independent. Prior experience in the superannuation sector could be an advantage and can strengthen the expertise of a trustee board.

In line with the ASX Principles, the SIS definition could be improved by specifying that an independent director must not have been involved with an employer or employee sponsor of the fund for a reasonable period of time before appointment to a trustee company board.

It would be appropriate for the chairperson of a trustee board to be independent in keeping with the ASX Governance Principles and APRA's requirement for banks and insurance companies to be independently chaired.

#### **5. Appointment of trustees**

The existing arrangements for the appointment of trustees for public offer funds, as set out in the governing rules of these funds, remain appropriate provided at least a majority of the directors of trustee company boards are independent.

The governing rules should allow for a healthy turnover of the membership of trustee company boards over time, e.g. by rotation, but we would not be too prescriptive in this regard as some flexibility in board composition is desirable to achieve a good mix of experience, judgement and fresh ideas.

Ideally, the appointment of trustees should be confirmed by fund members, as the appointment of directors is confirmed at company general meetings. However, changing the legal structure of superannuation funds to a more democratic model would require a radical transformation of the

governance of APRA-regulated funds which is probably not warranted at this stage if funds are moving towards more independent governance and higher standards of transparency.

While some aspects of governance, e.g. a requirement for the chair and the majority of trustees to be independent, might need to be expressed in legislation, the implementation of higher standards of governance is best left to prudential standards issued by APRA in consultation with the superannuation industry, which can be more easily adjusted over time as circumstances require.

## **6. Transparency – what should be disclosed?**

### *6.1 Governance*

As discussed above, APRA-regulated funds should disclose:

- The process for the appointment of trustee company directors
- The credentials of trustee company directors
- All directorships and senior executive positions held by trustees, including directorships of subsidiaries and related parties; and
- Remuneration of directors of the trustee company and its subsidiaries

### *6.2 Fund performance*

Members should be informed about the overall performance of the fund(s) in which they choose to invest their superannuation savings as well as the performance of their individual accounts.

For public offer funds, general information about performance should also be made available to all potential investors and their advisers and should be drawn together into one comprehensive annual statement, similar to the financial accounts presented by public companies. This should cover both the trustee company and the fund(s) it administers.

The following information should be provided to the market generally by public offer funds:

- Financial performance (return on investment) for each fund against sector benchmarks, over time. This analysis could be by reference to specialist providers who produce superannuation fund performance league tables
- Portfolio holdings - asset allocations by investment category, e.g. shares, property, cash, investment in derivatives, other managed funds, government and corporate bonds, infrastructure etc.
  - For each category, the split between Australian and overseas investments
  - For shares, direct and indirect, the investment by industry sector

### *6.3 Member account reporting*

Whilst we would generally be reluctant to suggest that the Government prescribe a format for how APRA-regulated funds should report the performance of accounts to members, concerns over the level of 'hidden' charges extracted from funds do suggest a greater degree of transparency is required.

It should not be too onerous for funds to report [on a rolling quarterly basis] to members a simple reconciliation as follows:

	\$	% of Opening Balance
Opening Balance		
Plus:		
Contributions		
Gross earnings*		
Realised Capital Gains		
Less:		
Taxes		
Fees**		
Pension withdrawals		
Closing Cash Balance		
Plus:		
Unrealised Capital Gains		
Closing Balance at Valuation		

\*Gross earnings means interest and dividends plus imputation credits

\*\*Fees should mean all costs incurred directly or indirectly by the fund and allocated to this beneficiary.

The regular reporting of such basic information – via the member’s online account access – will give members an opportunity to assess the performance of their individual account during the year rather than just annually.

#### *6.4 Trustee company disclosure*

As previously stated, the same principles as apply to public companies should be the default position for trustee companies.

First, the accounts should be made available publicly. In particular, they should clearly show all sources of income to the trustee company from the fund(s) it administers and other sources.

Financial statements should show:

- How trustee companies and funds earn revenue, identifying all sources:
  - fees and charges to fund members (identifying administration charges and percentage fees on funds held in the account)
  - any fees taken by a fund from investment income before striking a unit price
  - income derived from the unit price spread (the difference between the buy and sell price of units)
  - any fees, commissions or other payments related to life and permanent disability arrangements with external insurance providers
  - any use of tax refunds by the fund without passing on the full benefit to members
- How trustee companies and funds spend their members’ money, identifying significant cost items. These should include:
  - remuneration of trustees and senior executives
  - any commissions paid

- marketing expenses, particularly for public offer funds seeking to acquire new members outside the default group to build market share
  - membership and other payments made to industry associations/advocacy groups (amount, recipient and purpose)
  - donations made to organisations, particularly if related to employer/employee sponsors (amount, recipient and purpose)
- The basis on which taxes, e.g. earnings tax and capital gains tax, are allocated to individual member accounts, including the allocation of unrealised capital gains on account closure.

## **7. About SMSFOA**

The SMSF Owners' Alliance Limited was formed in November 2012 to be an independent voice for the trustees and members of self-managed superannuation funds. SMSFOA is a not-for-profit, limited liability public company. Since its formation, SMSFOA has made a number of submissions to the Government and to regulatory authorities.

More information is available at: [www.smsfoa.org.au](http://www.smsfoa.org.au)

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Numbers quoted in this submission are drawn from:

1. APRA Statistics – Annual Superannuation Bulletin – June 2013
2. APRA Monthly Banking Statistics – December 2013
3. ATO Self-managed superannuation fund statistics – June 2013