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Submission to the Productivity Commission inquiry into Superannuation Efficiency and Competitiveness

20 April 2016

1. Overview

This submission focuses on the lack of transparency required of the APRA-regulated superannuation funds (principally Industry and Retail funds) and the assumed detrimental effect this must have on the efficiency and competitiveness of the funds.

The funds control billions of dollars of Australian workers money that is effectively compulsorily taken from Australian workers. Yet there is no compulsion on the funds to disclose what they do with the money, how it is managed or where the money goes. If fact research demonstrates that many of the funds have little if any disclosure.

This lack of compulsory disclosure and the actual low levels of disclosure means that;

- the funds are subject to little if any public scrutiny
- the actual performance of the funds cannot be independently verified
- opportunity for misappropriation of money within the funds is high arguably posing a higher risk than that of the heavily regulated banks
- the efficiency of the funds cannot be reliably assessed
- the actual comparative performance of the funds cannot be reliably measured.

This submission calls for new laws to require of the APRA-regulated superannuation funds high levels of public disclosure and transparency of their management of Australian workers superannuation money.

2. Attachments

This submission provides examples of standards and models for disclosure to which the Australian government should aspire in its expectations and requirements of APRA funds. These standards are derived from:

- The Cooper Report recommendations.
- Institute of Public Affairs report on super disclosure.
- Self-Managed Super Fund Alliance.
- Comparisons with the disclosure standards observed by one of the world's largest superannuation funds, CalPers.

These are summarised below and copies of the relevant reports attached being

- Cooper report Chapter Four.
- Five (5) documents from CalPERS website
- IPA Report

3. Background
The APRA-regulated superannuation funds (principally Industry and Retail funds) have little, if any, legislative or regulatory requirement imposed on them to be transparent and disclose what they do with the money they hold in trust for Australian workers. APRA does not undertake any forensic analysis of the claimed performance of the funds. It only reports what the funds report.

This secrecy (for that is what it amounts to) around what the funds do with the hundreds of billions of dollars they control creates circumstances for bad management and under-performance as well as opportunities for corruption. The non-disclosure problem was highlighted in the 2010 Cooper Review into superannuation and in submissions to that review.

In reality, the security of Australians' superannuation money contained in APRA funds is potentially at risk because of non-disclosure.

The Cooper Report (Chapter 4) recommended a package of measures that should be imposed on APRA funds to ensure disclosure. Those recommendations have not been implemented.

4. Background disclosure; Government review

- The Rudd Labor government initiated the Cooper inquiry into superannuation with its Report released in July 2010.
- Chapter 4 of the Cooper Report (attached) recommended that major new disclosure requirements be imposed on the APRA-regulated (Industry & Retail etc) super funds.
- The government's response at the time to the Chapter 4 disclosure recommendations was to 'refer the matters to stakeholders for discussion'.

The levels of needed disclosure are easily identified through reference to the Cooper Report recommendations and other authoritative, independent sources.

5. The Cooper Report; Disclosure recommendations
Chapter 4 of the Cooper Report heavily criticized the lack of transparency in the super funds and recommended that high levels of disclosure be imposed. The Report said:

> The Australian superannuation system is characterised by a lack of transparency, comparability and, consequently, accountability. There is no standardised methodology for calculating and disclosing relevant fund or investment option information. Members often rely inappropriately on historical investment return data which gives no information about the risk attaching to those returns.
>
> The Panel proposes measures, including:
>
> 1. development by APRA (in consultation with ASIC and the industry) of outcomes reporting standards aimed at standardising the way in which performance and costs are reported;
> 2. a new forward- looking risk and return matrix complemented by disclosure for investment options in a user- friendly 'dashboard' style;

3. disclosure by trustees of all costs incurred by the fund, to at least the first non‐ associated entity level, classified into 'cost categories' for the purpose of benchmarking and improving fund efficiency and performance;

4. all past investment return information must be accompanied by information about its volatility and be stated net of all costs and after tax; and

5. a government website (www.super.gov.au) to be developed, displaying superannuation information and resources to enable Australians to understand and navigate Australia's superannuation system more effectively.

The Appendix to this submission (below) contains the full list of the 20 detailed Cooper Report disclosure recommendations. Chapter 4 of the Cooper Report is also attached.

If transparency is to be achieved so that the efficiency and competitiveness of the funds can actually be measured each of the 20 Cooper Report recommendations should be fully implemented.

6. The Self Managed Super Fund Alliance http://www.smsfalliance.com.au
The SMSFA has been an effective advocate for self-managed super fund owners. It has an interest in APRA funds because SMSFs often look to invest in APRA funds. In commenting on APRA funds' disclosure, the SMSFA has said

> 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.

Specifically

> 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.

The SMSFA also has said

> 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.

7. IPA report (April 2010)
Before the Cooper Review was completed, the Institute of Public Affairs released a report on APRA superannuation disclosure. The report, *Keeping Super Safe*, is attached and available at https://www.ipa.org.au/publications/1794/keeping-super-safe

In particular, the IPA report identified the broad structure of the Industry superannuation funds that allows extraction of moneys from the Industry funds. Essentially, the IPA report makes it clear that the level of Industry funds' secrecy and non-disclosure must raise concerns about the integrity of the funds.

The IPA highlighted a surprising fact that

> Neither APRA nor ASIC appears to undertake any form of direct auditing of the superannuation funds. (page 26)

The report said

> …the structure and interrelationships of the (industry) funds and their fund managers is little understood. What is disclosed through their websites and free public publications is relatively superficial. (page 13)

Further, that the Industry Funds have cascaded control of their funds to a 'web' of other entities so that there is virtually no information on how the superannuation funds' money is managed.

> At the heart of this web is an entity called Industry Super Holdings Pty Ltd (ISH) which is owned by a clutch of industry funds. In its last set of financial statements (available from ASIC 2009) ISH declared it controlled over $37.7bn in assets. ISH owns 100% of:
>
> - Industry Funds Management (funds under management $19.5bn)
> - ME Bank (worth $1.4bn)
> - ME Investments (funds under management $756m)
> - IRIS (worth $643m)
> - AusFund (funds under management $575m) and
> - Industry Funds Services (a provider of membership management, financial planning and other services).
>
> Each of these entities provides funds management and other services back to industry funds as 'outsourced' providers. But each of these service providers are owned by a corporate structure (ISH) which is in turn owned by industry funds. This makes for a highly complex and confusing disclosure regime. (page 13)
>
> Twelve people (2009) across the industry funds industry hold directorships or executive positions where they control $188 billion of financial assets. (page 21)

The IPA report explains the principles of disclosure that should apply:

> A fund member, investment advisor, or member of the public, should be able go into the website of any retail or industry superannuation fund and obtain enough information so they can understand where their money is invested, how it is performing relative to similar funds, who gets paid to manage and administer the fund, and how much is paid, and whether the fund's trustees have any cross-directorships. (page 5)

8. CalPERS as a model

The IPA report case-studied the California Public Employee's Retirement System (CalPERS) explaining:

> The California Public Employee's Retirement System (CalPERS) is one of the largest superannuation funds in the world, with assets of some $US200 billion (2009) covering 1.6 million workers and retirees. Its assets are larger than all of the Australian industry superannuation funds combined. (page 22)

On disclosure:

> CalPERS provides outstanding disclosure of assets, expenses, fees and commissions paid. This level of disclosure is far beyond any Australian super fund yet CalPERS still fell afoul of good governance. It was only through the level of disclosure of CalPERS that investigators were able to piece together the money trail to the 'political fixers' and 'peddlers masquerading as placement agents.'

In other words, because CalPERS had such high levels of disclosure, corruption within the organization was identified and stopped. This is one of the most important reassurances that can be offered to people who invest in superannuation funds. Corruption must be stopped early before the entire investment fund and system is put at risk. With the Australian APRA funds there is no way of discovering if corruption or potential corruption exists.

The IPA lists the disclosure levels that should be required (pages 28 to 39) and holds CalPERS up as the required standard. (pages 37 to 39)

Anyone is able to obtain a vast amount of information from the CalPERS website. As examples, screenshots taken from the CalPERS website are attached to this briefing note which show

1. Details of administration expenses.
2. Names of all consultants and their fees.
3. Domestic equities, real estate and mortgage loans showing relevant dates, acquisition prices and current prices.
4. All fund managers and fees paid.
5. High degree of detail of hedge fund portfolio.

** The information that the world's largest superannuation fund discloses to the public at large should be the standard of disclosure required of Australian APRA-regulated funds.

Appendix
Cooper Report Recommendations Chapter 4

Recommendation 4.1

With an enhanced rule- making power, APRA, in consultation with ASIC and industry, should develop outcomes reporting standards as an overlay to the existing accounting standards AAS 25 and ED 179 to facilitate consistent and comparable reporting by large APRA funds of investment performance and costs at investment option level, including for MySuper products.

Recommendation 4.2

In addition to whole of fund reporting, APRA should publish investment return performance data for MySuper products.

Recommendation 4.3

All funds should be required to publish on their websites an investment option performance table (as shown in table 4.1 in this chapter) showing investment returns and costs at investment option level, in accordance with an outcomes reporting standard to be developed by APRA in consultation with ASIC and the industry.

Recommendation 4.4

APRA should be the sole public sector agency responsible for collecting data for all public purposes in respect of all APRA funds and EPSSSs. APRA should have the primary responsibility for the publication of all superannuation data in as disaggregated a form as is consistent with privacy principles.

Recommendation 4.5

Relates to the ATO and SMSF. Not relevant to the APRA funds

Recommendation 4.6

It should be mandatory, when referring to past performance of a MySuper product or a choice investment option, to disclose a standardised measure of the uncertainty or volatility associated with the return (an example of which is shown in table 4.1 in chapter 4). This requirement, and the volatility measure to be used, should be in an outcomes reporting standard to developed by APRA in consultation with ASIC and the industry.

Recommendation 4.7

All forms of cost and fee disclosure by superannuation funds should be on a pre- tax basis, that is, gross of tax, in accordance with an outcomes reporting standard to be developed by APRA in consultation with ASIC and the industry.

Recommendation 4.8

An outcomes reporting standard should be developed by APRA, after consultation with ASIC and the industry, which would deal with how investment returns have to be calculated both gross and net of all costs (administration and investment) and taxes and then disclosed only in a format governed by the standard.

Recommendation 4.9

In consultation with industry, government should finalise the details of an investment option performance table for MySuper products and choice investment options, building on the model proposed by the Panel. APRA should then specify this in an outcomes reporting standard.

Specifically, the consultation would progress the development of a standardised disclosure format containing:

(a) gross investment returns, costs and investment returns net of all costs (administration and investment) and taxes for investment options for 1, 5, and 10- year periods; and

(b) the number of quarters of negative investment returns the investment option has incurred in the past 10 years, or a proxy figure developed using data published by APRA for those options with a history of less than 10 years.

Recommendation 4.10

Investment option performance table data would have to be maintained by trustees and be easily accessible on the fund's website for as long as the fund remains in existence.

A PRODUCT DASHBOARD (4.11 & 4.12)

"The Panel believes that information about the investment strategies of MySuper products and choice investment options should be displayed in a simple, plain- English 'product dashboard'. The product 'dashboard' would not substitute for a fuller description of the investment strategy or option by the trustee as may be required, that is, the 'dashboard' would not replace the PDS (including the new short- form PDS) or the equivalent on- line disclosure material developed for MySuper products."

Recommendation 4.11

Trustees of large APRA funds should disclose each diversified investment option's investment return target and risk target, as shown in Figure 4.1 of chapter 4 in a product 'dashboard'. A similar approach should be required for undiversified options, with the underlying asset class or classes being disclosed in place of the 'investment return target'.

Recommendation 4.12

In consultation with industry, APRA should develop an outcomes reporting standard dealing with all of the requirements for the product 'dashboard'. Specifically, the consultation should progress the development of a product 'dashboard' containing the:

(a) net investment return target (after- tax), which should be expressed as a percentage above CPI, over a rolling 10- year period;
(b) range of possible outcomes for a MySuper product or choice investment option (that is, risk target) over a 10- year period in a visual, diagrammatic format;
(c) the projected liquidity of the MySuper product or investment option;
(d) projected Total Annual Expense Ratio (TAER) which would capture all the projected costs to at least the first non- associated entity level; and
(e) relative ranking of overall fees (as collected and published by APRA).

Recommendation 4.13

As part of the development of an outcomes reporting standard, APRA, in consultation with the industry, would ensure trustees report costs to APRA on a consistent basis. The standard would prescribe:

(a) cost categories and their composition;
(b) requirement for cost categories to be subject to an annual audit;
(c) 'cost categories' to be reported in the APRA annual return at the whole of fund and MySuper levels; and

(d) costs to be disclosed to at least the first non-associated entity level.

Recommendation 4.14

Trustees offering MySuper products should be required to participate in APRA-approved benchmarking surveys that would measure their relative efficiency against peers in a number of key areas (for example, administration costs per member, service standards) in accordance with an outcomes reporting standard to be developed by APRA in consultation with ASIC and the industry. APRA should be required to publish the results of such benchmarking surveys.

Recommendation 4.15

APRA should have explicit powers to collect superannuation fund data on a 'look-through' basis so that it can achieve an understanding of the fund's asset allocation, risk, returns and costs.

Recommendation 4.16

Trustees of large APRA funds should be required to disclose their complete portfolio holdings on a six-monthly basis in accordance with an outcomes reporting standard to be developed by APRA in consultation with ASIC and the industry. This would require disclosure to APRA within 60 days after the end of each six month period, corresponding with normal financial years and half-years, and then public disclosure of the same information, on the fund's website, three months later.

Recommendation 4.17

Trustees of large APRA funds should maintain a website that provides, free of charge, systemic transparency about the fund and the fund's management.

Recommendation 4.18

Trustees should retain the last 10 years' worth of such information and make it available on the fund's website.

Recommendation 4.19

Trustees should be required to publish on the fund website the historical Total Annual Expense Ratio (TAER), which would capture the historical costs to at least the first non-associated entity level, for each MySuper product or choice investment option within the fund.

Recommendation 4.20

Government should task ASIC, in consultation with industry, other regulators and consumer groups, to establish a central website about superannuation to draw together features, including standard disclosure of legislative, tax and other super-related features, and to be a portal to other superannuation-related information. All large APRA funds would be required to link their websites to this site.