5 August 2016

12 Highland Way
Highton, 3216

Attn: Ms Karen Chester

Deputy Chair

Productivity Commission

Locked Bag 2, Collins St East
Melbourne VIC 8003,

Dear Deputy Chair

Re: Efficiency and Competiveness of the Superannuation System

Further to my letter dated 28 July 2016 please find attached a copy of a letter that I have written to Steve Burrell, Chief Executive, of the Governance Council of Australia in relation to this inquiry.

The governance of superannuation funds has a direct bearing on "*efficiency*", whether defined narrowly in terms of published fund returns or more broadly to take into account all system costs such as taxpayer funded regulatory costs and member funded compliance costs such as the need for legal advice and legal proceedings.

I trust the Commission will be taking the broader view and in any event I believe the Governance Council of Australia can make an important contribution to this inquiry.

Yours Sincerely

Phillip Sweeney

Attachment: **Letter to Governance Institute of Australia dated 5 August 2016**

5 August 2016

12 Highland Way
Highton, 3216

Attn: Steven Burrell

Chief Executive

Governance Institute of Australia

Level 10
5 Hunter St
Sydney 2000

Dear Mr Burrell

Re: Efficiency and Competiveness of the Superannuation System

The Productivity Commission is calling for submissions for the next stage of this inquiry {**Appendix A**}.

The High Court of Australian in ***Finch v Telstra Super Pty Ltd*** [2010] HCA 36; (2010) 242 CLR 254 ruled at [35]:

> "The government considers that the taxation advantages of superannuation should not be enjoyed unless superannuation funds are operating efficiently and lawfully. For that reason it has, by procuring the enactment of the *Superannuation Industry (Supervision) Act* 1993 (Cth) ("the Supervision Act") and regulations made under it, imposed quite rigorous regulatory standards."

I will be lodging a submission to this inquiry which will focus on any "*efficiency*" aspect that the Deputy Chair and Commissioner MacRae may have not considered.

This aspect will be highlighted by a case study where widows have been waiting for two decades to receive death benefits from a regulated superannuation fund now administered by a major bank.

One aspect of "*efficiency*" is the quantum of the final benefit compared to the contributions made by either the fund member or employer or both.

However another aspect of efficiency is how long do the members or beneficiaries need to wait until they receive their benefit entitlement after it has fallen due?

If a superannuation fund is being operated efficiently then there should be a minimum delay in paying a death benefit after a death certificate has been lodged with the fund for example.

If there is a delay that stretches into months, years and even decades then this is not indicative of an efficiently operated superannuation fund and that operational efficiency needs to be greatly improved.

This also raises the issue of *"dynamic efficiency"*, including services to members, which includes responses to complaints concerning a delay in benefit payments when they fall due or the failure to make any benefit payments at all.

Many fund members are "***locked***" into a given fund and are unable to utilise "***Choice of Fund***" legislation, especially older members who have retired or are soon to retire.

This limitation is not just due to "***some modern awards and enterprise bargaining agreements***" {Page 37 of the interim report}.

All members of ***Defined Benefit*** funds are "***locked***" into a given fund and cannot move to another fund.

Governance Issues

The interim report of the Commission has noted that there are many participants in the compulsory superannuation system, including fund members, their dependents, employers, unions, government regulatory agencies and the tax office.

"*Efficiency*" can be looked at narrowly such as the published returns of superannuation fund or on a wider scope which includes all system costs such as the cost of regulation and the cost of providing compensation in the event of malfeasance by the trustees of superannuation funds.

I am hoping that the Productivity Commission takes the wider view for this inquiry.

There are different types of superannuation funds.

For example there are ***Defined Benefit*** funds where the employer bears the investment risk and ***Defined Contribution*** Funds where the members bear the investment risk.

In **Defined Benefit** Fund the "*efficiency*" of net fund returns is more important to employers, whilst in **Defined Contribution** funds the "*efficiency*" of net fund returns is more important to fund members.

There are also what are called *"for-profit"* or *"Retail Funds"* and *"not-for-profit"* or *"Industry Funds"*.

The net returns after ***"fees and charges"*** is significantly higher for members of ***"not-for-profit"*** funds compared to that for members of ***"for-profit"*** funds as is to be expected {**Appendix B**}.

However if one takes a system wide approach there are other ***"efficiency"*** costs such as regulatory costs borne by the taxpayer in general and additional costs borne by fund members such as the opportunity costs of delayed payments (or non-payment of benefits) and compliance costs such as the cost of seeking legal advice or the cost of taking legal proceedings if necessary.

I draw your attention to a case of non-payment and delayed payment by the trustee of the staff superannuation fund of the Commonwealth Bank - ***Beck v Colonial Staff Super Pty Ltd & Ors*** [2015] NSWSC 723.

In this matter the trustee has refused to pay a former employee a pension benefit and instead only paid a lump sum benefit worth only a third of the value of the pension benefit. This case has dragged on for a decade and the member who took the proceedings has had to incur substantial legal costs.

In a <u>compulsory</u> superannuation system this should not have been necessary and the trustee should have sought judicial advice from the very beginning of this dispute as part of the trustee's statutory duty to act in the ***best interests*** of the fund members.

This then takes us to the important matter of fund governance.

There is a major difference in the fund governance models between *"for-profit"* superannuation funds and *"not-for-profit"* superannuation funds which has a direct bearing on the *"efficiency"* of these funds.

"Not-for-profit" funds utilise the ***"equal representation"*** model where there are an equal number of member representative directors as there are employer representative directors of the corporate trustee, whilst ***"for-profit"*** funds utilise the so called ***"independent"*** director model where none of the Directors are elected by members or unions.

In fact the parent bank or other financial institution holds the power to remove and appoint the directors therefore the so called ***"independent"*** directors are not *"independent"* at all.

There is also another important governance aspect and that is the Parliament has failed to mandate the holding of annual member meetings where fund members have a public forum in which to question the directors on the performance and administration of their fund. Shareholders in public companies have such a right when being a shareholder is not compulsory and where shareholders are free to sell shares in one company and buy shares in another if they have concerns about the management of the first company.

Members in a COMPULSORY superannuation system currently do not have this right and many are *"locked"* into one fund and cannot exercise any right to move to another fund, such as members of **Defined Benefit** funds.

This lack of transparency and accountability allows the imposition of excessive fees and charges by trustee directors who have an obvious conflict of interests in ***"for-profit"*** funds.

In an ideal world there should be no reason why all the directors of **Defined Contribution** funds should not be elected by the members of the fund since the members bear the investment risk.

In the case of **Defined Contribution** funds where the employer bears the investment risk, the well established *"equal representation"* model would be appropriate.

However in the real world the situation is more complicated since there has been substantial consolidation of the number of funds in the last two decades {**Appendix C**}, which means that most funds are ***"Hybrid"*** funds with both Defined Benefit ***"sub-funds"*** and Defined Contribution ***"sub-funds"***.

This makes arriving at the ideal governance model a more challenging exercise.

It is for this reason that I believe a submission from the ***Governance Institute of Australia*** for the Productivity Commission inquiry would be of great value.

Poor governance or a failure in governance can have major ramifications for fund members and beneficiaries.

I will be providing the Commission with a case study where widows have been waiting for two decades to receive their death benefits and governance failure is the root cause of this problem.

I look forward the reading the Institute's submission.

Yours Sincerely

Phillip Sweeney

cc

- Deputy Chair - Karen Chester
- Commissioner – Angela MacRae

Appendix A

Super review to scrutinise banks' power

Sally Rose and Sally Patten

The Productivity Commission will examine whether the growing power of bank-owned super funds should be curbed.

On Tuesday, the commission released a draft report for the first stage of a major three-part review into the competitiveness and efficiency of Australia's $2 trillion retirement savings system. It revealed that the way the "vertically integrated" business models of bank-owned super funds are performing will be scrutinised over the coming months.

Vertical integration refers to the model whereby the country's largest retail banks also own superannuation, funds management, administration, and insurance businesses that sell products and services to each other.

Productivity Commission deputy chair Karen Chester said the body had not yet formed a view on the business models of bank-owned super funds.

"We haven't formed any view as to whether vertical integration is overall a net positive or a net negative for members ... it would seem to depend on whether the right competitive pressures are at play," she said. "The important question is whether economies of scale are being realised and then passed on to members. We will be asking and answering that question next year in a later phase of this review."

Industry Super Australia chief executive David Whiteley welcomed the focus on retail funds. "The Productivity Commission seems to have understood the moral and economic imperative of getting the super system right," he said.

The report said the commission would examine whether bank-owned super funds had a competitive advantage, "as well as market power in other markets to create barriers to competition from other funds".

It said banks "may stifle competition" by favouring in-house services providers for administration and insurance. Retail funds which undertook administration in-house tended to pay more for the service and pass the cost on to their members, the report said.

On the other hand, the commission recognised that providing both banking and retirement savings products to customers could produce economies of scale and allow members the convenience of integrating their financial affairs with one institution.

The aim of the report was to outline the markers of success the commission will refer to in producing the next two stages of its report card on the super system. Next year the commission will begin work on suggested options for improving the way employers choose a default super fund for their workers.

The government has flagged it wants to overhaul the current system, whereby the Fair Work Commission is responsible for arbitrating how default funds are named in industrial awards.

While the retail super sector has welcomed the prospect of greater access to the $9 billion per year default super market, the suggestion has met with scepticism from the industry fund sector.

Financial Services Council chief executive Sally Loane said consumers got the best deal when markets were open and competitive.

"No one should be afraid of competition and we should all surely welcome a competitive market structure in superannuation, which we don't have under the current system," she said.

Although there are roughly 200 super funds vying for workers' retirement savings, more competitive pressures are needed to ensure members are getting a good deal, the report found. "Competition is not an end itself," Ms Chester said.

She said more focus was needed on maximising long-term net returns – that is how much extra money members earn on their savings after all fees, charges and taxes are deducted.

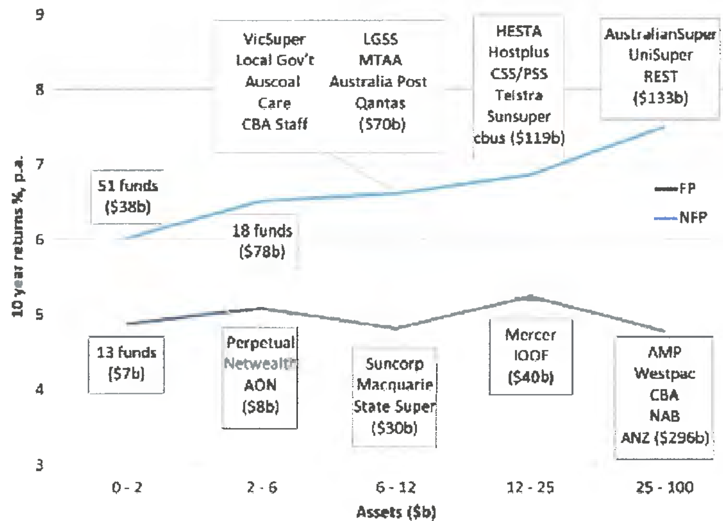
Providing insurance that "meets the member needs at least cost" was another priority.

Australian Prudential Regulation Authority deputy chairwoman Helen Rowell recently flagged she was worried some super funds were not negotiating group insurance deals in their members' best interests.

The draft report will be open for consultation until September 9, 2016.

Appendix B

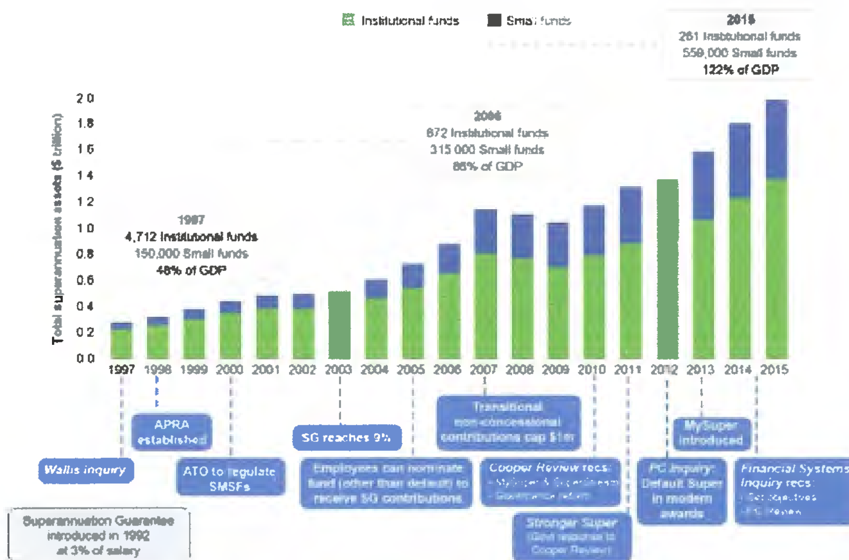
Figure 2 – Average fund level rate of return by profit orientation, 2004-2013



Source: APRA (2013) Fund level performance data and profiles, ISA analysis.

Appendix C

Figure 1.2 **Key developments in the modern superannuation system**[a]



[a] 'Institutional funds' comprise corporate, industry, public sector and retail funds. 'Small funds' comprise small APRA funds, single-member approved deposit funds and SMSFs

Data sources: ABS (Australian National Accounts: National Income, Expenditure and Product, Australia, March 2016, Cat. no. 5206.0); APRA (2007, 2014a, 2016c).