



Investment & Financial Services Association Ltd

IFSA Submission

Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System

Issues Paper – 25 August 2009

Phase One: Governance

INDEX

1.	Executive Summary and Recommendation 1	5
	1.1 The Australian Superannuation System	5
	1.2 Fundamental Issues	6
	1.3 The Review	8
2.	Summary of Recommendations	11
3.	Issues – APRA Regulated Funds	17
	5.1 General	17
	5.1.1 Global financial crisis	17
	5.1.2 Complexity	20
	5.1.3 Trust model for super	23
	5.1.4 UN Principles for Responsible Investment	25
	5.1.5 Public sector	27
	5.1.6 Best practice	27
	5.2 Trustees.....	29
	5.2.1 Trustees duties.....	29
	5.2.2 Trustee knowledge, skills and training	36
	5.2.3 Trustee performance	36
	5.2.4 Apprehension of personal liability	37
	5.2.5 Trustee independence	38
	5.2.6 Reliance on outsourcing	39
	5.2.7 Conflicts in outsourcing	39
	5.2.8 Composition of the boards and succession planning	39
	5.2.9 Stock lending	40
	5.2.10 Consolidation	41
	5.3 Government and regulatory	43
	5.3.1 Government policies	43
	5.3.2 APRA regulation	45
	5.3.3 Sanctions and enforcement	45
	5.3.4 Related party transactions	46
	5.3.5 2007 PJC Inquiry	46
	5.4 Accountability to members	48

5.4.1	Accountability to members	48
5.4.2	Corporate governance of underlying investments	50
5.4.3	Responsibility for investments	52
5.5	Operational	57
5.5.1	Investment Time Horizon	57
5.5.2	Tilt towards equities	57
5.5.3	Portfolio rebalancing	58
5.5.4	Leverage	59
5.5.5	Tax governance	59

1. Executive Summary and Recommendation

1.1 The Australian Superannuation System

The Australian approach to retirement savings has been praised globally as a world leading retirement system. Australians are fortunate that they have an established system that combines voluntary compulsory savings for retirement with an Age Pension safety net. Australia's basic retirement system rates well in any international comparison and the robustness of the Australian system is testament to its fundamental soundness.

The *Superannuation Industry (Supervision) Act 1993 (SIS)* provides the foundation of Australia's existing superannuation system and was enacted as part of a major reform package to address anticipated increases in age pension payments that would place a significant strain on the Australian economy. A "three pillars" approach to retirement income underpins this system, that is:

- a means-tested Government age pension system operating as a retirement income safety net;
- private savings generated through compulsory contributions to superannuation; and
- encouraging voluntary savings through superannuation and other investments.

While SIS has generally served Australians well, it is important to note that it was developed in a different regulatory environment than exists today. Since the enactment of SIS, major reforms have included the *Financial Services Reform Act 2002*, Fund Choice legislation¹ and licensing requirements for responsible superannuation entities (**RSE**). These reforms have fundamentally changed the dynamics for the operation of the superannuation system and have created an openly competitive environment across the range of superannuation providers. These factors, together with increased fund disclosure, numerous regulatory initiatives, prudential guides and member responsibility for both fund and investment selection, provide a regulatory landscape much different to that which existed at the enactment of SIS.

Given such change, it is incumbent on the Parliament to ensure that the law and its administration is not out of step with current day requirements and developments, including technological and market developments over the last 16 years. While the Australian system is structurally sound and works well, it is an opportune time to undertake a holistic review and refinement of SIS, the legislative platform for the operation of superannuation funds.

It needs to be stressed that superannuation savings are not only critical to Australia's retirement income policy but those savings are playing an increasingly important role in the Australian economy. Superannuation funds represent an important source of capital for Australian companies. As stated by the Secretary to the Treasury recently, superannuation funds have played an important role in facilitating the large-scale de-leveraging of Australian corporations, and that "It is not at all clear that such a large structural change in corporate financing could have been achieved without

¹ *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004*

our very substantial pool of superannuation savings”². Superannuation funds are also the source of approximately half of the venture capital funding and later stage private equity funding in Australia.³

As part of Phase One – Governance, the Review has raised a range of topical issues some of which have been the subject of recent debate. Governance, of course, covers not only superannuation fund management, the management of investment assets, and responsibility for investment options to members, but also what should and should not form part of Australia’s retirement platform. This is particularly important as Australians move from the accumulation stage of superannuation savings to the pension stage. In each of these stages the role of superannuation as a vehicle through which to increase Australians’ exposure to life insurance should not be downplayed.

It is important that the role of life insurance be acknowledged as a part of a retirement income strategy. A recent *Austrade* study revealed that the bulk of group life insurance in Australia is sold in conjunction with superannuation. This channel accounts for approximately 80 per cent of life insurance business.⁴ Further research indicates Australia’s significant level of underinsurance in traditional life insurance products. According to actuarial research undertaken in 2005 on behalf of IFSA, there is a gap of A\$1,370 billion between the level of life insurance cover held by Australian families and the level of cover required to shield against financial risk.⁵ While this matter will be specifically addressed in Phase Three of the Review, it is a matter that trustees as part of fund and member governance must address as part of their superannuation offerings.

1.2 Fundamental Issues

The structure for the regulation of superannuation in Australia should enable a viable industry that promotes competition and enables fund investors to save and maximise their retirement savings in a safe and secure environment. IFSA Members also consider that existing requirements can be finetuned to better reflect industry changes and consumer demands for greater efficiency and effectiveness.

IFSA has previously made submissions to the Government, and to various Parliamentary Committees, on a number of the matters referred to in the Terms of Reference. We believe this current Review provides an opportune moment to revisit some of the issues, particularly capital requirements for RSEs, liquidity and unit pricing.

Capital requirements

The confidence of fund members and the safety of our superannuation system is fundamental to fund member engagement in saving for their retirement. The primary risks for superannuation fund members are institutional risk, operational risk and investment risk. Capital requirements primarily address institutional and operational risk. Overlaying these risks is the real risk that a fund member’s level of financial literacy and understanding of their risk tolerance, investment time horizon, and asset allocation decisions.

² *Towards a better taxation of savings*, speech by Dr Ken Henry, Chair – Australia’s Future Tax System Review Panel and Secretary to the Treasury, to the Australian Conference of Economists Business Symposium, 1 October 2009.

³ *Venture Capital and Later Stage Private Equity, Australia, 2007-08*, ABS Catalogue Number 5678.0.

⁴ *Austrade, 2009, Insurance in Australia*, p. 19, at

<http://www.austrade.gov.au/ArticleDocuments/1358/Insurance-in-Australia-2009.pdf.aspx>

⁵ Research commissioned by IFSA in 2005 showed that only 4% Australian families with dependent children have adequate levels of insurance cover (that is 10 times earnings as recommended by Rice Warner Actuaries). This means that Australian families are critically underinsured to the tune of \$1.37 trillion

Where superannuation funds are not providing a defined benefit, capital is not required to underwrite either investment risk or life risk as benefits are linked to the actual market performance of selected investment options. However, institutional and operational risk permeate the whole system.

In its submission to the 2006 Parliamentary Joint Committee Inquiry into the Structure and Operation of the Superannuation Industry, IFSA recommended that the law not be amended to impose uniform capital requirements on trustees. We believe that this position should be reviewed and that capital requirements must underpin institutional and operational risk in the superannuation system.

As at June 2007, it was forecast that Australia's total funds under management will grow to around A\$2.5 trillion by 2015, 75% of which are superannuation savings⁶. The capital adequacy of RSEs is fundamental to ensuring the ability of trustees to address the operational risks and the financial capacity to ensure performance against adverse events. The capital requirements for trustees of public offer superannuation entities have a threefold purpose:

- (1) to provide financial resources to act as a buffer in the event of operational or governance failure;
- (2) evidence a commitment on the part of the trustee to its superannuation business; and
- (3) act as an incentive to the trustee to manage the entity well.

IFSA considers that the existing \$5 million capital requirement is inadequate and that economic capital should be assessed and allocated by considering the following components:

- (1) operational & regulatory risk;
- (2) market risk;
- (3) credit risk;
- (4) insurance risk;
- (5) strategic risk; and
- (6) fixed assets.

The operational and regulatory capital is assessed based on the various risk profiles. On a periodic basis these risk profiles are rolled-up into the Basel risk categories and assessed in-depth with business stakeholders. In this process each exposure is quantified.

Liquidity

The Global Financial Crisis (**GFC**) has highlighted issues in the governance of fund liquidity. Fund liquidity is primarily dependent on asset allocation, pricing methodology and the frequency of pricing. The lack of appropriate levels of fund liquidity will result in a trustee being unable to meet its obligations to members to pay benefits on time, to enable switches without distorting strategic asset allocations, or to facilitate portability under Fund Choice.

The requirements under SIS must be amended to align payment, portability and asset valuation requirements. See the discussion and recommendation at 5.1.1

⁶ Department of Innovation, Industry, Science and Research, Australian Government.

Unit-Pricing

IFSA believes that the most appropriate way to allocate investment earnings to investors is through the use of unit prices (in most circumstances calculated on a daily basis). This is the most equitable structure as an investor gets credited with the actual investment amount earned on their assets. It also gives the investor certainty as to what their account balance is at any point in time.

IFSA has established standards with respect to Scheme Pricing (IFSA Standard No.8.00), the valuation of Scheme assets and liabilities (IFSA Standard No. 9.00) and a standard setting out minimum requirements where incorrect prices have been calculated and transacted upon and for determining when compensation is required as a result of incorrect unit prices (IFSA Standard No. 17.00).

There are a range of methods used by providers in the industry to allocate investment earnings. The most common approach is to use unit prices, however a number of providers still use crediting rates to allocate investment earnings. This means the crediting rate applied is always an estimate of the investment earnings over the period and inequities can result. Individuals will always be better or worse off in a given period under this structure than under daily unit pricing.

Where daily unit pricing is not used, there can be significant misallocation of investment earnings in any particular period. This can be particularly problematic for an investor who is looking to invest a large lump sum or rollover. Under Choice of Fund, with increased investor movement in and out of superannuation funds, this is clearly an issue for investors. Our view is that unit pricing is the most equitable allocation method, as investors are credited with the actual returns earned on their investments from the day they invest.

Investor engagement

Critical to investors maximising their retirement savings in a safe and secure environment is that all participants in the industry can more easily understand their risks, benefits, duties and obligations. In what otherwise is a well working governance structure, too much complexity and unnecessary inconsistencies and overlap in the governing legislation and regulatory framework creates uncertainty for product providers, advisers and service providers which leads to difficulties in communicating to investors in the most succinct and clear manner possible.

Recommendation 1: IFSA recommends that the Government endorse the current structure, operation and governance of Australia's superannuation system and:

- (a) reviews capital requirements for superannuation trustees;
- (b) review payment, portability and asset valuation requirements under SIS; and
- (c) introduces uniform unit-pricing standards for all public offer APRA regulated superannuation funds.

1.3 The Review

As stated at 4.1 of the Issues Paper, "Governance broadly refers to the **ideas, laws, processes and systems** by which organisations are **operated, regulated and controlled** for the benefit of their relevant stakeholders". In focussing on Governance in a superannuation context we are primarily concerned with the requirements for competency and resources that are required by a Responsible

Superannuation Entity (**RSE**) to deliver promised outcomes or services to its superannuation fund members.

With such principles and safeguarding in mind, IFSA makes the following observations to the Review:

1. Any discussion of governance should focus on member outcomes as opposed to increased Government/Regulator intervention. Market forces, assisted by enhanced transparency, will deliver greater competition and better outcomes for members (including reduced costs).
2. In evaluating governance issues the Review Panel needs to be very cautious if benchmarking it internationally. The Australian system is unique, and as a maturing defined contribution system it is difficult to find meaningful and truly comparable systems.
3. Both a managed fund responsible entity and a responsible superannuation entity are subject to general law trust obligations. Governance standards applying to superannuation should be at least as high as those that apply to managed investment schemes under the Corporations Act. While the requirements of managed investment schemes and superannuation funds are similar, the requirement for a majority of independent directors or a compliance committee with a majority of independent directors does not apply in a superannuation context.
4. Conflicts are unavoidable. They exist in all and any structure (whether a trust or not). Trustees are already required by law to manage conflicts to properly perform their functions and powers (including resources, skill and expertise) and this is appropriate. The primary focus should be on the competency of trustees to identify and manage those conflicts and those whom they have engaged to conduct the fund's operations.
5. Responsibility for investments – funds which offer many investment options generally do so to enable the efficient and cost effective delivery of financial advice. This is in the member's best interests. However, we believe the role of financial advice should be formally recognised in SIS.
6. While the formulation of the investment strategy(s) for the fund is the responsibility of the trustee, the selection of one or a combination of investments is the responsibility of the member. We do not believe there should be any prescribed investments for superannuation.
7. We favour principles based (not prescriptive) legislation and regulations. The existing legislative framework could be simplified and standardised to achieve the same regulatory and governance outcome in a more efficient and less costly manner. This in turn would improve the ability to communicate succinctly and clearly with investors and enhance investor engagement. Clear, concise and effective legislation and regulatory framework will allow the industry to provide that same standard to investors.

8. Consultation processes with Government and regulators must be improved. IFSA supports the establishment of a formal consultative industry committee structure for reviewing proposed changes to laws and regulation – see IFSA 2006 Regulatory Headland Statement⁷.
9. We encourage the review panel not to make any final recommendations on issues relating to governance until consultation on phases 2 and 3 of the review are complete. The governance arrangements that are appropriate may depend upon the nature of the findings and recommendations of those final two phases of the review.

⁷ http://www.ifsa.com.au/documents/2006_Publications_Regulation.pdf

SUMMARY OF RECOMMENDATIONS

Recommendation 1: IFSA recommends that the Government endorse the current structure, operation and governance of Australia's superannuation system and:

- (a) reviews capital requirements for superannuation trustees;
- (b) review payment, portability and asset valuation requirements under SIS; and
- (c) introduces uniform unit-pricing standards for all public offer APRA regulated superannuation funds.

Recommendation 2: IFSA recommends that:

- (a) Government in conjunction with industry take steps to further educate Australians of the importance of and operation of the superannuation system through various education programs, including the primary and secondary education of children.
- (b) SIS be amended to:
 - (i) expressly recognise the role of financial advice in superannuation; and
 - (ii) clarify the obligations of the trustee in investment selection.

Recommendation 3: IFSA recommends that:

- (a) illiquid funds or investment options be defined as those with 20% or more invested in illiquid assets (aligned to the Corporations Act definition of liquid scheme – section 601KA(5));
- (b) illiquid assets be valued at least 12 monthly;
- (c) illiquid funds be required to align their redemption and valuation process to preserve equity and guard against arbitrage;
- (d) valuation frequency will drive the timing of redemptions and investment applications. For example, if valuations are done once a quarter for all illiquid assets of the fund, redemptions and the processing of investment applications would be quarterly. If the trustees deemed it too expensive to revalue all assets every quarter they can chose a half year or annual valuation and investment application / redemption window;
- (e) pension payments could only be made at the same frequency as the revaluation of all the illiquids;
- (f) "illiquid" funds or investment options would need to be clearly and prominently disclosed in the PDS;
- (g) SIS would need to be amended to accommodate this change while the portability rules under SIS regulation 6.34 should also be amended;
- (h) various legislative amendments be amended governing the timing of payment of pensions, cash benefits, rollovers, family law benefits, death benefits, tax liabilities paid from members' accounts and other liabilities to align with the disclosed valuation frequency and investment and withdrawal windows. This includes recognition that the liquidity status may change and existing continuous disclosure obligations to the regulators and investors can or should be allowed to communicate this;

- (i) With respect to the above, special consideration should be given to superannuation that is provided through a life insurance company as those products may be subject to additional legislative and contractual requirements which limit the life company's ability to alter application and redemption timeframes.

Recommendation 4: IFSA recommends that the process for consolidation of superannuation accounts be simplified and that greater use of TFNs be made in the process.

Recommendation 5: IFSA recommends that:

- (a) a formal consultative process be established for proposed Government legislation and regulations, and for standards, class orders, guidelines, policy statements and practice notes issued by regulators that have broad application to the financial services industry; and
- (b) a Financial Services Committee be established on a permanent basis to consider draft regulatory reforms and provide to Parliament its comments and/or endorsement of regulatory proposals.

Recommendation 6: IFSA recommends that:

- (a) APRA and ASIC work more closely to ensure overlap is minimised and that where overlap does exist, the requirements of each regulator are consistent.;
- (b) the trustee of a public offer superannuation fund should be required to hold only a single licence covering its activities as trustee; and
- (c) ASIC and APRA be required to co-ordinate their activity in areas of regulatory overlap.

Recommendation 7: IFSA recommends that the trust model be maintained as a primary model for superannuation funds but that SIS be amended to more properly reflect the responsibilities of fund members.

Recommendation 8: IFSA recommends that consideration be given to allowing life companies to offer superannuation policies, without a superannuation fund trust structure.

Recommendation 9: IFSA recommends that superannuation fund participation with the UNPRI should remain voluntary. To mandate participation would be an unwelcome constraint on trustees which would diminish their role.

Recommendation 10: IFSA recommends that the governance requirements of defined contribution public sector superannuation funds should be the same as private sector funds.

Recommendation 11: The duties and responsibilities of trustees provide a firm basis for the development of 'best practice' governance. Trustees are charged

at all times with acting in the best interests of their members. IFSA recommends that regulation permit competition on even terms and best practice will be set by competitive forces.

Recommendation 12: IFSA recommends that any review of the current statutory requirements seek:

- (a) to better align those obligation with the general law requirements to remove uncertainty; and
- (b) to remove inconsistency between the Corporations Act and SIS.

Recommendation 13: IFSA recommends that SIS not be amended to codify the existing good faith obligation inherent in the requirement for a trustee to act in the best interests of fund members.

Recommendation 14: IFSA considers, in relation to conflicts of interest, that:

- (a) the existing trust model contemplates that conflicts will arise and need to be managed; and
- (b) section 52(2) of SIS supports the trustee in its obligations to manage conflicts.

IFSA recommends that there be no further codification of the law in relation to conflicts management as none is needed.

Recommendation 15: IFSA considers that there is no need to introduce rules in relation to the personal profit of trustees in the delivery of trustee services. Accountability is addressed in the context of existing general law obligations and through statutory disclosure.

Recommendation 16: The general law, trust structure, and relevant statutes already require that member or policy holder interests receive priority over the interests of the trustee or operator. IFSA considers that there is no need to introduce rules in relation to the member priority.

Recommendation 17: IFSA considers that there is no need to introduce rules outside the existing general law requirements to manage conflicts of interest.

Recommendation 18: IFSA acknowledges the current arrangements for assessing the governance of superannuation funds is robust and supports the development of superannuation league tables that provide a snap shot of the trustee company, the type of superannuation fund and its particular investment offering, performance at the investment option level and cost of the fund.

Recommendation 19: IFSA acknowledges the significant responsibilities of superannuation trustees and supports the existing protections provided under sections 56 and 57 of SIS.

Recommendation 20: IFSA recommends that governance requirements involving superannuation board composition and operation should be aligned with the requirements of Part 5C.5 of the Corporations Act and that a compliance committee with a majority of independent members be established where the trustee board does not have a majority of independent directors.

Recommendation 21: IFSA recommends against prescribing rules about the qualifications, length of time in office, multiple trusteeships and selection processes for trustees. The matter is one for the trustee board to consider as a whole having regard to their responsibilities to manage the fund in the best interests of members.

Recommendation 22: IFSA recommends that the ability to engage in stock lending for the benefit of fund members should be left to the discretion of the superannuation fund trustee.

Recommendation 23: IFSA supports the enactment of legislation that will facilitate product rationalisation across the superannuation, life insurance and managed investments industry. That legislation should address taxation and regulatory barriers to rationalisation.

IFSA does not support mandating the rationalisation of small superannuation funds.

Recommendation 24: IFSA recommends that:

- (a) the role of trustees in acting in the best interests of their members be endorsed and that investment decisions be based solely of what is in the interests of the members;
- (b) decisions to invest in assets that have broader societal benefits be undertaken by the trustee only on the basis that such investments are directed towards maximising the financial returns to members and that taxation concessions by Government may feature in any such decision.
- (c) The appropriateness of longer term investments such as infrastructure investments be determined by the trustee on the basis of :
 - (i) the age profile of the members;
 - (ii) their risk tolerance;
 - (iii) the size of the fund;
 - (iv) its likely growth rate; and
 - (v) the need to maintain liquidity to meet immediate obligations of the fund.

Recommendation 25: IFSA does not support APRA having a prudential standard making power in relation to defined contribution funds. This is the role of the Parliament and experience shows this power increases the complexity and overlap in regulation.

Recommendation 26: IFSA does not support any increase in sanctions and enforcement powers under SIS.

Recommendation 27: IFSA recommends that disclosure requirements applicable to a public company should apply to trustees of all superannuation funds. The law need not require the trustee of a superannuation entity to be a public company.

Recommendation 28: IFSA recommends that the public tender of key service agreements not be required. Market practice in this area is not deficient the exercise is not justified on a cost benefit basis particularly where there is an expectation from fund members that the trustee will engage related entities in the provision of superannuation services.

Recommendation 29: IFSA considers that:

- (a) member interests are protected under the trust structure and that the Superannuation Complaints Tribunal provides an appropriate venue for the determination of disputes relation to the operation of the fund or the exercise by the trustee of discretions.
- (b) AGMs or online AGMs would not be widely supported by fund members;
- (c) the public tender of key service agreements not be required.

Recommendation 30: IFSA considers that the management of fund assets is properly the responsibility of the trustee. The role of the trustee is to seek to maximise the return to members. Issues of governance of assets in which the trustee is invested on behalf of members is secondary to that purpose. IFSA recommends the maintenance of the status quo.

Recommendation 31: IFSA recommends that:

- (a) SIS be amended to make clear that while a SIS trustee is responsible for providing suitable investment strategies to fund members, it is not responsible for individual member investment choice within those strategies;
- (b) SIS be amended to clarify the operation of the relevant SIS provisions by:
 - (i) expressly providing a carve out for trustee responsibility from policing asset diversification where member investment choice is provided;
 - (ii) recognise that asset diversification limits are a discretionary matter for each trustee having regard to its assessment of the risk and return characteristics of the investment choices provided in their product offerings;
 - (iii) expressly recognising the trustee, in the performance of its fiduciary responsibilities to members, should be able to take into account factors such as role of advice or members' direction/choice in a superannuation context .

Recommendation 32: IFSA recommends that asset allocation restrictions be considered for individuals invested in the funds default option.

Recommendation 33: IFSA recommends that portfolio rebalancing strategies be clearly disclosed to members and that the naming of asset allocations within particular ranges be standardised.

Recommendation 34: IFSA recommends that best industry practice be allowed to evolve in after tax reporting.

ISSUES – APRA-REGULATED FUNDS

5.1 General

5.1.1 **Global financial crisis:** Did the global financial crisis highlight any governance problems in our superannuation system (for example, in risk or liquidity management) and, if so, what were they?

The Global Financial Crisis (**GFC**) has presented a range of governance challenges to superannuation trustees and highlighted certain weaknesses in our current regulatory system. However, on the whole, the industry has held up well during the toughest conditions for financial services in 80 years.

As stated in the Review's Issues Paper⁸, "Governance broadly refers to the **ideas, laws, processes and systems** by which organisations are **operated, regulated and controlled** for the benefit of their relevant stakeholders". It is a credit to industry governance that a crisis of this magnitude has been effectively managed.

Maintaining investor confidence was a primary Governance challenge arising from the GFC. Weaknesses in existing requirements were highlighted by issues in fund liquidity and an example of requirements imposing costs that outweigh intended benefits is superannuation account consolidation.

(1) Member confidence

Public offer superannuation is an account based regime where the experience of the individual member is dependent on asset selection and investment performance. Superannuation trustees must manage the interests of members through various economic cycles. This includes the management of the scheme and, making available suitable investment options and strategies that will permit appropriate diversification by the member.

A primary challenge for superannuation fund trustees during the GFC has been to maintain the confidence of fund members in a financial system that is under stress. The financial returns to members are subject to investment risk and cannot be guaranteed. It is widely understood that risk of loss is associated with a lack of diversification in investment; hence multiple investment options are offered to superannuants.

As economic and investment data heralding the GFC became known, superannuation trustees issued a range of publications to further educate their members and to reinforce the nature of superannuation as a long term savings and investment vehicle.

Member confidence, however, requires both an understanding of and stability in the requirements for superannuation. Many Australians are effectively disengaged from their superannuation and look at it, certainly in the earlier years, as another form of taxation. This, we believe, requires the initiation by Government in conjunction with industry of educational programs commenced at a primary and secondary school level.

Australia's retirement income system depends upon effective information, education and advice to enable people to find their way through complex decisions. The GFC

⁸ Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, The Scope of the Review – A Three phase consultation, 25 August 2009 at paragraph 4.1.

highlighted a problem in the level of member education. This has to some extent been ameliorated through the availability of professional financial adviser networks. Financial advisers play a critical role in the planning and provision of long term savings. Advisers bridge the advice gap that exists between the trustee and the superannuation fund member.

While the Government has taken steps to allow limited personal advice to members by the trustee through a superannuation fund, the lack of any formal recognition in SIS to the provision or the need for financial advice is a serious failing in the Act.

Recommendation 2: IFSA recommends that:

- (a) Government in conjunction with industry take steps to further educate Australians of the importance of, and operation of, the superannuation system through various education programs, including the primary and secondary education of children.
- (b) SIS be amended to:
 - (i) expressly recognise the role of financial advice in superannuation; and
 - (ii) clarify the obligations of the trustee in investment selection.

(2) Liquidity

Investment diversification is a fundamental tenet of modern portfolio and risk management theory. Superannuation members should be able to invest in illiquid assets as part of their investment diversification strategy. However, recent experience has brought into focus the need for consistent rules to govern funds (and investment options) with high levels of illiquid assets.

The GFC and the flight to safety as a consequence of the Government guarantee of bank deposits (less than \$1M) created liquidity issues for some trustees and their fund members invested in certain unlisted investment options through implemented investment strategies. The large number of managed funds which became illiquid posed substantial governance, operational and legal issues for trustees.

Illiquid investments exposed governance issues in regulation of benefit payments, rollovers and other fund liabilities. The various time limits imposed by legislation are inconsistent and 'clunky'. In the case of rollovers, the regulations contemplate investments that are illiquid but not what to do when an investment temporarily becomes illiquid. In order to give effect to the transfer of a member's interest which is invested in illiquid assets, the trustee will typically have to take money from a liquid investment option (or borrow an option which may not be a prudent one). This invariably will impact adversely on other members. This issue was raised by IFSA with the regulator in the early stages of the GFC as an evolving problem. The response, as in the case of hardship relief provided by ASIC in respect of mortgage funds, was to provide instruments of variation of the law on an individual application basis. Where a problem highlights a systemic industry or sector issue, we consider that action on an individual basis will not result in an optimal outcome.

As a first step, IFSA recommends an alignment between the concept of liquidity in managed investments under the Corporations Act and under SIS. Secondly, the legislative framework for asset liquidity, valuation and redemption must be reviewed to ensure that member equity and certainty is provided.

Greater coordination between the application of benefit payment, pension and other liability payment standards and section 155 of the SIS Act (the obligation not to issue or redeem interests at a fair and reasonable) price, would have made this crisis easier to govern without adversely affecting members. The law in this area must be clarified to give greater certainty to trustee's in exercising their responsibilities under the law.

Recommendation 3: IFSA recommends that:

- (a) illiquid funds or investment options be defined as those with 20% or more invested in illiquid assets (aligned to the Corporations Act definition of liquid scheme – section 601KA(5));
- (b) illiquid assets be valued at least 12 monthly;
- (c) illiquid funds be required to align their redemption and valuation process to preserve equity and guard against arbitrage;
- (d) valuation frequency will drive the timing of redemptions and investment applications. For example, if valuations are done once a quarter for all illiquid assets of the fund, redemptions and the processing of investment applications would be quarterly. If the trustees deemed it too expensive to revalue all assets every quarter they can chose a half year or annual valuation and investment application / redemption window;
- (e) pension payments could only be made at the same frequency as the revaluation of all the illiquids;
- (f) “illiquid” funds or investment options would need to be clearly and prominently disclosed in the PDS;
- (g) SIS would need to be amended to accommodate this change while the portability rules under SIS regulation 6.34 should also be amended;
- (h) various legislative amendments be amended governing the timing of payment of pensions, cash benefits, rollovers, family law benefits, death benefits, tax liabilities paid from members' accounts and other liabilities to align with the disclosed valuation frequency and investment and withdrawal windows. This includes recognition that the liquidity status may change and existing continuous disclosure obligations to the regulators and investors can or should be allowed to communicate this;
- (i) With respect to the above, special consideration should be given to superannuation that is provided through a life insurance company as those products may be subject to additional legislative and contractual requirements which limit the life company's ability to alter application and redemption timeframes.

(3) Consolidation of superannuation accounts

The GFC focussed the attention of many superannuation members on the desirability of consolidating their superannuation accounts and thereby minimising account fees.

The administrative complexity associated with consolidating superannuation operates, however, as a deterrent to consolidation. The requirements for consolidation need to be simplified and a single application developed that can be given to the target superannuation fund to initiate consolidation. The process should be as simple and effective as the processing of a direct debit request in the banking system.

The process should require a client to give specific authority to the Superannuation Fund to aggregate their superannuation accounts. The trustee will hold the authority and request the transfer from the other superannuation funds. Simplifying this and other processes may be made easier with the use of tax file numbers (TFNs) as a member identifier.

Recommendation 4: IFSA recommends that the process for consolidation of superannuation accounts be simplified and that greater use of TFNs be made in the process.

5.1.2 Complexity: Is it the case that the complexity of the superannuation system creates its own governance problems? If so, what are some examples? Are there any governance requirements that are no longer necessary or impose costs that outweigh intended benefits?

Complexity of the superannuation system is best addressed through the streamlining of various processes (eg consolidation of superannuation accounts) and focussed principles based legislation that allows for innovation of delivery and service. Complexity is a systematic issue and requires a systematic response. A focus on examples and quick fixes will not solve the issues of further complexity being introduced in the future.

SIS provides a structural framework for superannuation and some of the rules for the operation of superannuation funds (superannuation trustees must comply with the requirements of their trust deed and other laws that are applicable either directly or indirectly). Complexity within the superannuation system is evident in the legislative and regulatory framework and arises primarily from:

1. complex legislation, regulations, class orders, regulatory commentary that makes it difficult to even establish what the law is;
2. drafting of legislation, regulations and class orders in a manner that is not clear, concise nor effective and accordingly makes it difficult for providers to comply with that standard;
3. a multi layered regulatory environment due to the grandfathering of certain requirements when rules are changed; eg preservations, contributions and income streams – this produces complexity and increased administrative costs;
4. inconsistency in terminology for the same or substantially similar parts of the superannuation system (eg. member contributions in the SIS Regulations compared to non-concessional contributions in the Tax Act), which flows though to making disclosure very difficult and complex;
5. different superfund classifications generating different requirements;
6. regulatory overlap and the existence of multiple superannuation regulators – APRA and ASIC as primary regulators in terms of governance, AUSTRAC and ATO as secondary regulators.

Increased complexity has the potential to reduce member understanding and awareness of superannuation generally, and of their superannuation assets specifically. Ongoing changes to the rules, including the reduction of the concessional contribution caps announced in the 2008 Budget, have contributed to a reduction in public confidence to such an extent that many individuals are now reluctant to provide for their retirement beyond the required minimum levels, or are reluctant to use the superannuation system as the primary retirement saving vehicle.

Complexity reduces both engagement and participation.

(1) Complexity - Multiple requirements

The management of multiple operational requirements present significant governance challenges. Complexity in legal requirements often results in the development of business processes that are cumbersome and costly. As an example, any change which affects a member's benefit reporting requires costly system upgrades because many of the changes are made on an ad hoc basis.

The seemingly continual amendments to the superannuation laws and requirements directly contribute to greater operational risk and the need for additional compliance procedures and arrangements. Additional legislative requirements have created complexity that leads to confusion among trustees, fund administrators and superannuation fund members, making member engagement more difficult and resulting in higher compliance and risk management costs.

One large provider estimates approximately 20-30% of total 'system' work (new and fixes) relates to regulatory changes. Further important points in relation to this:

- Given the short lead-time for many of the changes, the urgency of a change may result in a reallocation of existing resources occupying 50-70% of total system work for a period of time to meet implementation deadlines. This restricts other necessary system work and can hold up product improvement projects etc.
- When changes are introduced with short lead-times, there can be a flow-on effect on the quality of implementation, resulting in greater spend as later corrections are made to assumptions and work-arounds that were necessary to meet the deadlines.

A recent example of an ad hoc change to the law was the introduction of requirements through the Corporations Regulations for the presentation of long term performance information on member periodic statements⁹. While the policy objective was laudable, it was introduced with minimal meaningful consultation, did not take account of different superannuation structures, and has in some instances resulted in requirements to produce information that is irrelevant to an individual member eg it effectively required superannuation wrap accounts to calculate whole of fund 5 year performance figures that bear no relevance to individual member investment choice or experience.

Industry sought amendment of the requirements, advising both Government and ASIC that the Regulations in their current form would significantly increase fund costs and result in disclosures that are potentially misleading to fund members. The three largest superannuation wrap/master trust providers estimated the increased cost to be approximately \$240,000 each to produce the Member Statements for 2008/2009.

How can complexity and the attendant costs be addressed? What industry requires is a consultation process for policy development and legislative implementation which enables industry to minimise the level of complication associated with change; i.e. comprehensive consultations, adequate implementation lead times, adequate scope to rectify legislative amendments that prove to be deficient.

⁹ Corporations Amendment Regulations 2009 (No.3)

Rethinking how legislation is drafted and its structure to provide easy reference and easy to understand legislation should also be considered. This would translate to efficiency gains and less complexity. This would in turn encourage accountability and should also improve trustees' ability to communicate to members and feel comfortable in explaining their role.

Recommendation 5: IFSA recommends that:

- (a) a formal consultative process be established for proposed Government legislation and regulations, and for standards, class orders, guidelines, policy statements and practice notes issued by regulators that have broad application to the financial services industry; and
- (b) a Financial Services Committee be established on a permanent basis to consider draft regulatory reforms and provide to Parliament its comments and/or endorsement of regulatory proposals.

(2) Different superannuation classifications

Public offer superannuation funds should be subject to the same core governance requirements.

(3) Regulatory Overlap and Cost

(a) Multiple Regulators

The dual primary regulator approach to the financial services sector introduced by the *Financial Services Reform Act 2002* was premised on assumption that each regulator would have functionally different responsibilities, and that where a financial services provider was subject to dual regulation there would be little or no overlap in regulation or in reporting obligations. The practice has been quite different, and changes made to legislation in recent years has worsened, rather than improved this situation.

Both superannuation funds and managed investment schemes operate under a trust structure, trustees are required to be licensed, are subject to similar capital requirements and, both require formal compliance arrangements to be in place and to be audited annually. This dual regulation results in a significant level of regulatory overlap. Arguably, the limited prudential supervision exercised by ASIC in relation to managed investment schemes has the same basis as the prudential supervision exercised by APRA in relation to public offer superannuation funds.

APRA and ASIC need to work more closely to ensure overlap is minimised and that where overlap does exist, the requirements of each regulator are consistent. For example, in relation to conflicts, outsourcing etc.

(b) Licensing

We now have circumstances where a superannuation trustee has to comply with similar but different licence obligations (an Australian Financial Services Licence (**AFSL**) and a Responsible Superannuation Entity Licence (**RSE Licence**) imposed by ASIC and APRA in relation to fitness and propriety, conflicts of interest etc. This dual regulation and licensing creates regulatory duplication, overlap and inconsistency which add to the compliance burden of the funds.

Following amendments to the Corporations Act, a trustee of a public offer superannuation fund typically needed an Australian Financial Services Licence (AFSL) to provide general advice and to deal in superannuation products. The requirement for a superannuation trustee to be licensed to provide general advice in relation to its own products was subsequently removed. As a consequence, most public offer trustees now only need to maintain an AFSL in order to deal in superannuation products, or if they choose to provide financial advice.

While only licensed for this one activity, a trustee's reporting obligations to ASIC are onerous, covering a wide range of legislation and the trustee's other (non-licensed) activities. Under the current regime, there is no justification for the continued requirement for superannuation trustees to have an AFSL, unless they choose to undertake activities that are not core to the operation of a superannuation fund, such as provide personal financial advice to members.

APRA and ASIC under the dual regulatory model should continue to improve their coordination efforts where there is overlap in regulatory responsibilities. Funds would benefit from a more strategic and coordinated approach. This might mean it is appropriate for the regulators to implement or introduce new initiatives within the same window each year. This would make it easier for funds to plan for such change.

Recommendation 6: IFSA recommends that:

- (a) APRA and ASIC work more closely to ensure overlap is minimised and that where overlap does exist, the requirements of each regulator are consistent.;
- (b) the trustee of a public offer superannuation fund should be required to hold only a single licence covering its activities as trustee; and
- (c) ASIC and APRA be required to co-ordinate their activity in areas of regulatory overlap.

5.1.3 Trust model for super: Superannuation funds operate under a trustee model derived from the general law of equity. Given the nature of today's public offer, and other large, super funds, is this model still appropriate? Does it still deliver the best outcomes for members?

IFSA acknowledges that globally there are alternative models for superannuation. However, in terms of governance we consider that the Australian system provides a sound basis for member protection and delivering best outcomes for members. It should be noted that under a traditional trust structure, the trustee must act in the best interests of members as a whole which does not necessarily mean that the action taken is necessarily always in the best interests of a particular member. The modification of the traditional trust structure to accommodate individual member accounts and to facilitate member investment choice introduces a significant element of control by the individual member in determining investment selection having regard to the whole of the member's circumstances.

The Australian trustee model has evolved to enable best outcomes for members. The existing combination of a trustee and statutory requirement model underpinning the

Australian superannuation system has successfully weathered the GFC and shown itself to be both robust and protective of members' interests.

The risk of fraud or collapse in superannuation has greatly diminished since the introduction of superannuation licensing requirements that has required trustees to demonstrate that they have the expertise and capacity to perform their responsibilities as superannuation fund trustees and has required compliance arrangements on the fund and the trustee to be mapped through their formal compliance plan and compliance strategy. That model and these requirements soundly underpin our superannuation system.

While there has been some technical criticism of the current combined trust and statutory model¹⁰, the model does maximise member protection. Any change from a trust model would, in a majority of cases, involve significant costs which would be passed on to members and lead to lower retirement incomes. One of the advantages of the trust structure is that trust assets are protected from creditors in the event of the insolvency of the trustee. If there was a move to another form of legal relationship, such as a contractual relationship, this would require sweeping changes to SIS to introduce the concept of priority in the event of insolvency, as applies in the banking and insurance arenas.

The operation and services provided by public offer superannuation funds have evolved significantly since the enactment of SIS. While the Act provides a solid foundation for the operation and activities of superannuation funds, it does not clearly reflect the increasing control and powers provided to fund members through investment choice, member choice of fund for employer contributions, and binding death benefit nominations. The approach often taken by APRA is premised on a traditional view of the all powerful trustee with full discretion, powers and responsibilities, and the passive beneficiary with no control.

SIS needs to be changed to more fundamentally reflect this change in the power dynamic between trustee and member. The Act should be amended to more clearly reflect the existence of member responsibility and investment choice. However, these would be clarification to the existing law. Unless the benefits of an alternative model justified those costs, no move away from the trust model should occur. As to whether the model should continue to be derived principally from the general law of equity, see the answer to question 5.2.1, below.

Recommendation 7: IFSA recommends that the trust model be maintained as a primary model for superannuation funds but that SIS be amended to more properly reflect the responsibilities of fund members.

Life company superannuation offerings

Life companies should be permitted to offer superannuation policies, without a superannuation fund trust structure. This should be available as an alternative to life companies using the existing trust structure.

This option is particularly appropriate where the focus of a financial services conglomerate's superannuation business is its life company (eg all investments are made into life policies, and the life company performs administration services and provides risk cover). In this situation, the trust structure creates additional

¹⁰ 'The SIS Covenants and Duties – Shades and Reflections of the General Law?' Dr Lisa Butler, Senior Lecturer in Law, University of Tasmania, Counsel Freehills

'Problems with the Covenants in SIS', Marita Wall, Barrister.

complexity, and the whole "conflicts" issue is making it increasingly challenging for financial services conglomerates who want to offer a single fully branded offering.

This is an issue for all conglomerates with life companies. It creates regulatory duplication (APRA supervising 2 product entities in respect of the same business - the superannuation fund trustee, and then the life company whom the trustee invests into via life policies) and is, in our view, unnecessary. There are clear inefficiencies, with unnecessary costs which are ultimately passed on to the fund members.

It would be far simpler and more transparent for the investor to deal just with the life company, directly. Life companies are prudentially regulated, and operate under a strong regime. There is no question around the adequacy and strength of the life insurance prudential regime. There is, therefore, little (if any) incremental protection provided by the additional overlay of the trust structure.

Life companies' products are already recognised in legislation such as SIS. Life companies have successfully offered (and continue to offer) a number of superannuation products for many years - such as deferred annuities, lifetime annuities, allocated annuities etc. Plus, they have provided risk benefits for stand alone superannuation products. The only thing they have been unable to do is offer products with a regular contribution facility combined with optional insurance cover, and we do not see any incremental risk in them doing so. For example, allocated annuities require intensive levels of administration to pay down the annuity stream: it is no harder to receive a contribution stream.

Recommendation 8: IFSA recommends that consideration be given to allowing life companies to offer superannuation policies, without a superannuation fund trust structure.

5.1.4 UN Principles for Responsible Investment (UNPRI): How should APRA-regulated super funds approach the question of becoming a signatory to the UNPRI or a similar set of principles? Should adopting such principles be mandatory? If this is not the right approach, then what would be preferable?

The UNPRI is now widely accepted in the global pension fund sector. IFSA strongly encourages its members through the IFSA Blue Book¹¹ to engage in environmental and social issues. Guideline 5 of Part One of the Blue Book provides:

Guideline 5 - Environmental and Social Issues and Corporate Governance

Fund Managers should engage companies on significant environmental and social issues that have the potential to impact on current or future company reputation and performance. The governance of a company has long been established as a major factor impacting on potential and actual company financial performance. It is now well accepted that issues such as environmental and social issues faced by a company may contribute towards financial performance in the short, medium and long term.

¹¹ IFSA Guidance Note No.2, Corporate Governance: A Guide for Fund Managers and Corporations (June 2009)

IFSA members should engage companies on their significant environment and social issues that have the potential to impact on company perception and performance. Companies should also be encouraged to explain how they identify and manage their significant environmental and social risks.

The United Nations Principles for Responsible Investment (UNPRI) are recognised as providing a solid framework within which Fund Managers may engage companies regarding environmental and social issues. While the uptake of the UNPRI is strong within Australia, it is recognised that not all Fund Managers are in a position to become signatories to the initiative, because of resource limitations and/or the lack of consistent data in the marketplace. Fund Managers who are not signatories are encouraged to use the UNPRI as a framework for company engagement. IFSA also encourages research houses to work with the professional investment community and Australian companies to develop investment grade research to assist Fund Managers to assess company performance regarding their environmental and social risk management.

UNPRI has over 500 signatories representing approximately US\$18 trillion in assets. The acceptance of the UNPRI reflects mainstream concern about the integration of environmental, social and governance (**ESG**) factors in relation to the management of assets for the long term.

The decision to adopt the UNPRI or any similar set of principles should remain voluntary for all APRA-regulated super funds. IFSA does not support the mandating of participation with the UNPRI as this would be contrary to the spirit of the UNPRI and an unwelcome constraint on trustees which would diminish their role. In this regard the statement of the Senate Select Committee on Superannuation, in its report entitled *Investment of Australia's Superannuation Savings* (December 1996) remains true. The Committee stated:

2.26 There is some pressure in Australia for trustees to use their investment powers in various socially responsible ways. Doing so, in the absence of other concerns, may prejudice the duty to act solely for the benefit of contributors. 'Pension funds stand as tantalising vehicles for those advocating the use of funds to achieve other objectives such as regional development or employment creation.' In the Committee's view, any consideration of the use of superannuation funds in this way must be in full recognition that the funds are the sole property of the members.

Becoming a UNPRI signatory is a matter for trustees to determine having regard to:

- their fiduciary role and obligations to superannuation fund members;
- the sole purpose of SIS being for the provision and management of superannuation and retirement savings.

Numerous IFSA members are signatories to UNPRI and many superannuation funds appoint investment managers that are signatories. IFSA has promoted greater consideration of ESG considerations through its revised Blue Book launched in June 2009 and through initiatives to better inform its members such as jointly commissioning (with ACSI) a research paper on ESG ¹².

¹² *ESG integration of mainstream Australian Equities Managers*, Mercer (May 2009)

The strength of the UNPRI is its collaborative, voluntary approach to investment and, as such, it provides trustees with an opportunity to evaluate their own investment policy and the relative merits of participating with initiatives such as the UNPRI. IFSA believes that it is consistent with the spirit of the UNPRI for participation to continue to be voluntary, to ensure that super funds are joining for the right reasons and not because they are being mandated or pressured to do so.

IFSA supports the encouragement of super funds assessing the merits of joining the UNPRI. This could include an evaluation of the pros and cons of signing the UNPRI based on each fund's circumstances, including members' long term interests and the trustee's attitude to how best to discharge its fiduciary duty. The costs involved in signing the UNPRI (such as the voluntary fee, the annual assessment review and any internal resources allocated to participating in the UNPRI need to be weighed against the potential benefits to each fund (such as the cost savings from collaborative engagement, the credibility of adhering to guiding principles that are widely accepted internationally and the focus on risk management).

The UNPRI is now widely accepted in the global pension fund sector.

Recommendation 9: IFSA recommends that superannuation fund participation with the UNPRI should remain voluntary. To mandate participation would be an unwelcome constraint on trustees which would diminish their role.

5.1.5 Public sector: Are there governance issues specific to public sector funds? If so, what are they?

In principle, the governance requirements for superannuation trustees should be the same. Public sector superannuation has to date been treated by government as a separate arm of superannuation policy under government management and control. Governments have closed most of their defined benefit schemes and established defined contribution schemes for new employees and defined benefit fund members who choose to switch to them. IFSA is of the view that, in a choice environment, there should be a level playing field and the costs of running defined contribution public sector superannuation schemes should be carried by the members, and the governance arrangements for public sector superannuation funds should be identical to the governance arrangements required of private superannuation funds.

Recommendation 10: IFSA recommends that the governance requirements of defined contribution public sector superannuation funds should be the same as private sector funds.

5.1.6 Best practice: What is the best way to drive best practice governance across the industry, for example, in the areas of transparency, disclosure, conflicts management, environmental, social and corporate governance and shareholder participation?

Best practice governance is achieved through transparency and competition. Sustainable best practices standards cannot be achieved by greater regulation. Regulation/legislation should set a minimum requirement. Best practice will

ultimately be set by competitive forces, with industry associations largely driving best practice standards.

Best practice is an evolving concept and involves effective and efficient communication and administration. In a governance context best practice involves a board establishing an appropriate governance framework to oversee the management and to manage the operational risks of the fund. It involves informed and objective evaluation by a collective of experienced board members.

As a concept within the funds management industry, best practice has evolved with technological improvements. As a result of technological development there have been significant improvements in communication, administration, accountability and efficiency. Best practice regulation is facilitated through the development of industry standards and guidelines.

Best practice means finding and using the best ways of working to achieve your objectives. In practice, it means keeping up to date with the ways that successful businesses operate – in your sector and others and measuring your ways of working against those used by the market leaders. To apply best practice, you need to learn from and through the experience of others.

Within the Australian superannuation industry, there are a large number of public offer superannuation funds and a smaller number of corporate funds. Additionally, the number of individuals choosing self managed funds as the means of saving for retirement is steadily growing. Each fund has its own underlying objectives and, over the years, has developed the methods of operation, management and communication by which to best achieve these objectives.

The industry is already heavily regulated through the operation of the SIS and regulations, the Corporations Act and regulations, class orders, regulatory guides, guidance notes, circulars and prudential practice guides. The views of each regulator (as expressed in the various forms of industry guidance) are not always aligned and do not always reflect what is generally accepted by the industry to be the 'best' way of achieving its primary objective – the protection and growth of retirement income. The existing body of regulation already prescribes minimum benefit protection standards, investment considerations and core disclosure obligations. Best practice is achieved by industry in delivering outcomes to their members.

The key consideration in the development of any practice which is accepted by industry as the 'best' way of achieving the stated objective should be that it drives the right behaviour. Whether the practice relates to disclosure, conflicts management, environmental, social and corporate governance or shareholder participation the aim should be the same – to adopt a standard which not only reflects accepted good industry practice and protects members but that encourages industry to strive to achieve excellence.

Any attempt to prescribe Best Practice at a point in time suffers the very real likelihood of becoming a barrier to the evolution of industry Best Practice.

In summary any attempt to prescribe best practice is:

- self defeating. Minimum standards should be prescribed and competition allowed to improve market efficiency;
- quickly out of date and may prevent innovation and enhancement;
- may restrict innovation, including product innovation which in a competitive market seeks to improve financial services and products;

Recommendation 11: The duties and responsibilities of trustees provide a firm basis for the development of 'best practice' governance. Trustees are charged at all time with acting in the best interests of their members. IFSA recommends that regulation permit competition on even terms and best practice will be set by competitive forces,

5.2 Trustees

5.2.1 Trustee duties: Would the full or partial codification of duties to act in good faith, avoid and/or disclose real or apparent conflict of interest and not seek personal profit have a significant impact on trustee governance and the priorities given to various aspects of their operations?

Would explicit provisions setting the priority of shareholder and member interests and enabling trustees to override deeds that require the trustee to invest or outsource within the corporate group help reduce trustee conflicts of interest?

Should any additional duties apply to superannuation fund trustees?

1. Trustee governance and priorities

Full or Partial Codification

The trustee duties to act in good faith, avoid and/or disclose real or apparent conflict of interest and not seek personal profit are to some extent already codified (or at least replicated, with greater or lesser modification) by section 52 of SIS and section 912A of the Corporations Act, and continue to operate in the general law.

Partial codification under SIS has already complicated adherence to the general law trust duties a trustee must act in accordance with. Further codification is unnecessary. This issue was strongly debated at the time of developing the SIS Act. Recent commentary suggests that codification of the duties has hindered rather than helped the law in this area evolve.

There are, however, two main areas of uncertainty in the application of the existing law, where the uncertainty could be reduced or removed as part of a broader review exercise:

- *relationship between statutory law and general law:* there has long been a debate about the relationship between the statutory covenants in section 52(2) of SIS and the corresponding (or related) duties of a trustee under the general law. Some experts have favoured the view that the statutory covenants codify the general law; others that they re-state the general law without codifying (ie excluding) it; and still others that the covenants neither codify nor restate the general law, but merely deal with the same or similar topics in ways that differ (to a greater or lesser extent) to the general law. This ongoing debate has produced uncertainty for trustees which has negative consequences (including increased costs) for members;
- *duplication in the statutory law:* a substantial majority of Australian superannuation trustees hold financial services licences and, as such, are subject to the requirements of section 912A of the Corporations Act. There is a significant degree of overlap between the statutory obligations imposed

under SIS and those imposed on financial services licensees under the Corporations Act. IFSA submits that the opportunity should be taken to remove the overlap and that doing so will increase certainty and reduce costs for members.

The Corporations Act already recognises, to a limited extent, that duplication is undesirable and should be avoided. For example, the obligations to have adequate resources (section 912A(1)(d)) and to have adequate risk management systems (section 912A(1)(h)) do not apply if “*the licensee is a body regulated by APRA*”. IFSA submits that this concept should be expanded to all instances where the same topic is regulated by both SIS and the Corporations Act. For example, in the case of an ASIC licensed trustee, conflicts of interest are regulated both under section 912(1)(aa) of the Corporations Act as well as under section 52(2)(e) of SIS. The broader issue of conflicts of interest is discussed further below. For present purposes, it is sufficient to note that:

- these provisions deal with the same topic in different ways,
- this is a clear case of unnecessary duplication, and
- it is duplication that creates uncertainty for trustees and consequential costs for members.

Recommendation 12: IFSA recommends that any review of the current statutory requirements seek:

- (a) to better align those obligation with the general law requirements to remove uncertainty; and
- (b) to remove inconsistency between the Corporations Act and SIS.

Good faith

Consistent with the general commentary provided above, in relation to any proposal to codify the general law duty to act in good faith, the trustee is already required “to ensure that the trustee’s duties and powers are performed and exercised in the best interests of the beneficiaries” (section 52(2)(c) of SIS).

IFSA submits that this covenant, together with other covenants set out in section 52(2), already cover the same ground as the general law duty to act in good faith. In addition, trustees who are holders of AFSs are subject to the analogous duty to act ‘efficiently honestly and fairly’ imposed by section 912A of the Corporations Act. Accordingly, IFSA submits that little would be gained by specifically including such a duty as a separate covenant.

We believe the best interests test is sufficient. We don’t believe that adding the ‘good faith’ requirement into section 52 (thereby codifying it) does anything to clarify a trustee’s obligations or provide any additional protection / benefit for members. If a trustee is acting in the best interests of beneficiaries, they must be acting in good faith.

Codification has arguably resulted in the misunderstanding of the “best interests” test. Under general law this test was always, for very good reason developed over many, many years a test about whether the trustee was acting in the whole of the members’ interests as opposed to another person’s interest (including its own).

You can act in the members' best interests without optimising the outcome for each and every member. This distinction is a very important one that has developed in the general law over a long period, for the very reason that is totally impractical and in most cases impossible to get the best result (with the benefit of hindsight) for each and every member. The test does require that in seeking outcomes for a member the trustee does not prefer the interests of itself or another person over what is best for the members as a whole. This very fundamental misunderstanding of the test (together with the breadth of when it is applied) has led to much of the confusion arising in the governance of superannuation funds.

Recommendation 13: IFSA recommends that SIS not be amended to codify the existing good faith obligation inherent in the requirement for a trustee to act in the best interests of fund members.

Conflict of interest

The potential for conflicts of interest to arise are inherent in all business structures (other than a sole trader) and are acknowledged and dealt with under the general law. Taken to its extreme, avoidance of conflicts would have the effect of undermining existing industry structures. These structures have delivered significant industry efficiencies and benefits.

The obligation to manage a conflict of interest is fundamental to the way a trustee carries out its obligations. The general law is different from and is, in our view, more onerous than the statutory law. It would be difficult for a superannuation trustee to have complied with its existing obligations without considering and managing conflicts of interest. While there are often close relationships between the trustee and the corporate group, the trustee would not be able to enter into these arrangements unless these arrangements are for the benefit of the superannuation fund and its members. Based upon a proper process of identifying and managing conflicts, any decision to use other members of the corporate group may be more beneficial to members. The vertical integration of financial services provides customers with efficient and cost effective access to investment products and services. Vertical integration is a problem only in a poorly contested market where it can result in less competition and market manipulation. This is not the case in the Australian financial services market which is well contested, highly competitive and delivers significant financial and economic benefits to customers.

In relation to any proposal to codify the general law relating to conflicts of duty and interest, the trustee is already required "not to enter into any contract, or do anything else, that would prevent the trustee from, or hinder the trustee in, properly performing or exercising the trustee's functions and powers" (section 52(2)(e) of SIS). Accordingly, the issue of conflicts is already addressed in section 52(2).

Recommendation 14: IFSA considers, in relation to conflicts of interest, that:

- (a) the trust existing model contemplates that conflicts will arise and need to be managed; and
- (b) section 52(2) of SIS supports the trustee in its obligations to manage conflicts.

IFSA recommends that there be no further codification of the law in relation to conflicts management as none is needed.

Personal profit

IFSA submits that no specific statutory rules should be introduced in relation to the personal profit of a trustee. Historically trustees have always had an indemnity against the fund assets to the extent governed by the trust deed.

The Courts have recently confirmed that a trustee should be able to take fees for its service from the fund assets - see *Cuesuper Pty Ltd* [2009 NSWSC 981]. This case recognised that trustees, acting in the best interests of members, can and should be remunerated appropriately from assets of the fund for the work they perform.

IFSA considers that any issues associated with the personal profit of a superannuation trustee are appropriately addressed through a combination of disclosure and the trustee's duties in relation to conflicts (whatever the precise content of those duties – see above). In IFSA's view, there is no need for, nor any demonstrated justification for, specific independent rules relating to personal profit.

Recommendation 15: IFSA considers that there is no need to introduce rules in relation to the personal profit of trustees in the delivery of trustee services. Accountability is addressed in the context of existing general law obligations and through statutory disclosure.

Priorities

IFSA does not believe that it is necessary to introduce legislation to enable a trustee to override trust deed provisions that require a trustee to invest in or outsource within the corporate group. Superannuation funds in Australia operate within a number of different corporate and business structures that are designed to deliver greater efficiencies, services and benefits to fund members. Within the context of a corporate group offering, a superannuation fund will offer a range of both tangible and intangible benefits – reputation, efficiencies of scale, capital backing, integrated services.

In a superannuation fund choice environment, to retain a member trustees must meet member expectations. A trustee, acting in the best interests of members as a whole and discharging its duties to members, must consider whether internally sourced functions are and continue to be, in members' best interests. In the governance, management and delivery of trustee services to members a trustee will take into account:

- members' reasonable expectations on entering the fund and disclosure in relation to the outsourced functions;
- the impact of choice of fund and portability rules;
- continued monitoring of service providers;
- the likelihood of being able to source alternative providers at the same or similar costs (see embedded arrangements section below).

Recommendation 16: The general law, trust structure, and relevant statutes already require that member or policy holder interests receive priority over the interests of the trustee or operator. IFSA considers that there is no need to introduce rules in relation to the member priority.

2. Outsourcing - Embedded arrangements

The Committee has asked: "Would explicit provisions setting the priority of shareholder and member interests and enabling trustees to override deeds that require the trustee to invest or outsource within the corporate group help reduce trustee conflicts of interest?"

IFSA suggests that this question may be premised on an overly broad view of what may constitute a "conflict of interest" and what should be required where a conflict exists. In particular, the question seems to contemplate the possibility of two broad models for the governance of funds, and subtly suggests that one of these models is the superior model but without (explicitly at least) requiring the adoption of that model. APRA has been expressing a particular view on these matters in recent times and promoting its preferred model.

The two models can be summarised as follows:

- the "APRA's Preferred Model" – under which the trustee has an over arching obligation to source the "best available" service providers as an outworking of its "best interests" duty. In our view this model does not reflect the legal position, however it seems nonetheless to be promoted by APRA as a "best practice" model. Under this model, there would be no preferred status conferred on any one provider (including a related party of the trustee) and the expectation of APRA and investors would be that the trustee should periodically review the arrangements, potentially conducting tenders and the like in order to secure the "best available" services at the "best available" price. This model is predicated on the trustee having to undertake significant ongoing work in relation to the appointment of service providers, for which the trustee will require additional resources and potentially fees.
- the "Embedded or Internal Service Provider Model" – under this model, the understanding and expectation of members is that a particular service provider would be appointed, as disclosed when the member joined the fund. The trustee's role is one of oversight in terms of ensuring that prescribed standards are met, as opposed to having the service provider in effect under continual review as against alternative service providers but must consider the competency of the management and operations which carry out the functions of the super fund on its behalf.

Under this model, the trustee is not obliged to compare the embedded service provider against the universe of alternative service providers.

Conferring on trustees a statutory power to override deeds that provide for embedded arrangements would potentially create confusion in the industry. On the one hand, the proposal implies support for APRA's Preferred Model, but on the other hand, there must be some recognition that fund members have chosen the product on a particular basis and that this should be respected. As stated in an IFSA submission to APRA dated 17 July 2008:

"....., The financial services market in Australia is characterised by a significant degree of horizontal and vertical business integration in addition to boutique operations.

Related party arrangements within conglomerates have been a common feature of the Australian financial services industry for some time. The diversity within our industry is a significant strength and offers investors a wide range of investment choices. Taken to its extreme, avoidance of conflicts would have the effect of undermining existing industry structures and

operations. These structures have delivered significant industry efficiencies and benefits to customers. “

The vertical integration of financial services provides fund members with efficient and cost effective access to various investment products and services. Vertical integration is a problem only in a poorly contested market where it can result in less competition and market manipulation. This is not the case in the Australian superannuation market which is well contested, highly competitive and delivers significant financial and economic benefits to customers. In the process of making a purchase decision customers are influenced by factors such as brand, reputation, utility, efficiency, reliability, risk as well as current and past relationships.

A proposal to introduce a statutory power to override trust deeds that provide for embedded arrangements could create some kind of "halfway house" where a trustee can continue to operate on the basis of the Embedded Service Provider Model so long as it changes to APRA's Preferred Model if at any time it considers this to be "in the best interests" of members.

It is untenable, in IFSA's view, to require superannuation trustees to be considering, on a continual basis, whether and if so when, to switch between two completely different models of operation. How, in practical terms can a trustee discharge its obligations under such a regime? Must the trustee periodically conduct tenders to assist it in determining whether to change models? What if there are insufficient responses to a tender request? What guidance would there be for trustees as to the triggers that should prompt a trustee to restructure an Embedded Service Provider Model fund to conform to APRA's Preferred Model?

The proposal appears to assume that a trustee will readily be able to ascertain the "best" service provider at any time. This is a simplistic view which assumes that the "best" service provider can readily be identified (presumably on the basis of price and, for an investment manager, historical investment performance). There are, of course, many other factors to consider.

Although for example it is acknowledged that there are potential conflicts of interests under the Embedded Service Provider Model, it also needs to be recognised that in most circumstances the interests of the relevant service provider and the trustee are actually aligned. The service provider has often invested significantly in its brand and reputation. This can be a factor in a service provider agreeing to pay ex gratia compensation to a fund trustee where errors occur, even though there may be no legal liability on its part to do so. Similarly, the fact of the parties being related tends, in practice, to give trustee directors greater access to, and influence in relation to, the service provider. In many cases, a large part of the service provider's business is based on offering its products and services through the related superannuation fund. Accordingly, the trustee is likely to be in a much stronger bargaining position with a related party service provider than it would be in dealing with an arm's length service provider who may simply walk away from the relationship if the commercial terms no longer suit.

In summary, IFSA makes the following points:

- (a) The trust model is appropriate for super and should not be interfered with. Overriding a fundamental tenet of trust law to comply with the terms of trust deeds would be a huge shift in approach that would have ramifications for the operation and administration of super funds generally;
- (b) The trust model incorporates well established principles regarding trustee duties, obligations, rights and powers. These do not require any further codification as they are well understood;

- (c) Under the trust model priority does not need to be further clarified between the interests of members, shareholders and other stakeholders;
- (d) The trust model contemplates that conflicts will arise and need to be managed but does not mandate or require that arrangements have to be structured to avoid them arising at all;
- (e) Conflicts in the super context are a fact of commercial life but they are not per se illegal or offensive;
- (f) Trustees in practice fully disclose these arrangements and are still obliged to monitor performance of all service providers;
- (g) While allowing trustees to override trust deed terms would on its face reduce potential conflicts, it would also alter some fundamental principles on which trust law is based. This would be unnecessary and unwarranted;
- (h) Trustees still have obligations to review and monitor performance and can and do act when issues arise. They do have options they can take if service delivery issues arise and are often in a better position to influence related service providers to get those issues resolved. The terms of the arrangements are often more favourable than third party providers will commit to eg liability, service levels, etc.;
- (i) Best interests test works and it would be counterproductive to apply a higher standard (ie 'best available service provider') on trustees; and
- (j) Any fundamental change like that contemplated would lead to:
 - confusion about the standards that apply and the criteria to be used to rate providers. This in turn will lead to additional potential liability for trustees and a reduction in the available talent pool for trustees;
 - administrative burden in running regular outsourcing tenders and reviews;
 - significant inefficiencies and transition costs as trustees move between service providers more frequently (involving eg tax and brokerage fees, transition manager fees, systems changes, opportunity cost etc etc);
 - alterations to representations made to members regarding product offerings (ie they will not be getting the product they thought they were buying and still want);
 - herd instinct driving trustees to seek safe harbours, leading to consolidation of providers which in turn over time will reduce competition and innovation but not reduce fee levels. Concentration risk will increase;
 - undermine the values attributed by members to brand, reputation, capital backing of the trustee and its product offerings etc ;
 - reduced protection for members as service providers limit liability to trustees.

Recommendation 17: IFSA considers that there is no need to introduce rules outside the existing general law requirements to manage conflicts of interest.

5.2.2 Trustee knowledge, skills and training: Are trustees adequately equipped to do their jobs? Is too much expected of trustees?

See 5.2.8

5.2.3 Trustee performance: How is trustee performance measured? How should it be measured? Can and do trustees adequately measure their own performance? Are there adequate benchmarks? What are, or should be, the consequences for under-performance?

Performance measurement

The quality of trustee performance is difficult to measure. IFSA supports the concept of comprehensive league tables. League tables should provide individuals with a snap shot of; the trustee company, the type of superannuation fund and its particular investment offering, performance at the investment option level and cost of the fund. To be a worthwhile tool, league tables should:

- Be accurate and compare “like with like” (at investment option level)
- Be comprehensive (i.e. cover all funds in the market)
- Be publicly and easily available
- Cover all relevant aspects of a fund (e.g. fees, performance, investment choice, service, insurance premiums, product features)

Such tables do not exist in Australia. Below is a high level analysis of what is available:

	Accurate and compare like with like	Comprehensive	Publicly and easily available	Cover all relevant aspects of a fund
Chant West	√	X	X	√
Super Ratings	X	X	X	?
APRA	X	√	√	X

Properly constructed publicly available league tables will drive competition and consequent member benefits in the superannuation industry.

Governance requirements

IFSA members recognise that the SIS covenants and general law duties impose high standards of conduct on trustees that can only be discharged if appropriate governance structures and processes are in place. A robust corporate governance framework necessarily requires regular review of the board’s functions and performance. However, IFSA submits that each board should have the flexibility to craft its own governance framework with reference to the scale, structure and nature of each trustee’s operations. Assistance in developing standards for governance is readily available to trustee boards through the work of bodies such as IFSA, the Australian Institute of Company Directors and the Chartered Secretaries Association. Analogies may also be drawn from the ASX Principles of Good Governance.

In addition, APRA performs prudential reviews of most trustees on an annual basis. These reviews involve extensive examination of trustee governance arrangements, including:

- examination of board and committee charters, papers and minutes;
- meetings with trustee directors;
- Review of the trustee's risk management strategy, framework and controls;
- Review of arrangements to manage conflicts; and
- Review of compliance arrangements.

APRA's prudential reviews take into account emerging developments in governance best practice and provide a de facto benchmarking mechanism among industry peers. The findings of prudential reviews form part of APRA's risk rating assessment (SOARS and PAIRS ratings). A high risk rating by APRA will result in increased regulatory oversight and may lead to other regulatory sanctions.

The trustee's risk management strategy, which includes key governance controls, is also subject to annual external audit. Finally, each director is required by SIS to be subjected to initial and ongoing fitness and propriety assessment. IFSA submits that further review of trustee performance is not necessary and should not be mandated, as this would only add to cost with little member benefit.

Trustee boards can successfully manage their liability risk through:

- having in place sound corporate governance practices;
- taking expert independent advice, where appropriate;
- having in place robust compliance regimes; and
- ensuring that all board members are appropriately trained and qualified.

Recommendation 18: IFSA acknowledges the current arrangements for assessing the governance of superannuation funds is robust and supports the development of superannuation League tables that provide a snapshot of the trustee company, the type of superannuation fund and its particular investment offering, performance at the investment option level and cost of the fund.

5.2.4 Apprehension of personal liability: Is trustee behaviour adversely affected by their apprehension of personal liability, thereby making fund governance more problematic, or is there an adequate balance between the duties of trustees and their potential liability in the case of a contravention?

In our experience well trained and qualified trustees are not apprehensive of making decisions for the members of the trust due to fear of personal liability. There is ample protection under the Act, the trust deeds and under the general law where the trustee exercises their duties appropriately and fairly.

That said, there should be no dilution of the protections afforded to superannuation trustees and directors under sections 56 and 57 of SIS. Those protections play an important role in attracting and retaining suitably qualified companies and individuals. Any dilution of those protections could create a real prospect of a lack of companies and individuals prepared to take on these important roles.

Recommendation 19: IFSA acknowledges the significant responsibilities of superannuation trustees and supports the existing protections provided under sections 56 and 57 of SIS.

5.2.5 Trustee independence: Should trustees be members of a fund of which they are a trustee so their interests are more fully aligned, or should they not have a personal interest in the fund?

The merits of having independent directors on company boards have been and will continue to be the subject of debate, substantial review and research. A recent article reviewing *Corporate governance and the financial crisis*¹³ concluded, having reviewed various empirical studies, that “independence is no guarantee of effective risk management. On the contrary, effective risk management may require that non-executive directors know more about the financial industry”. Another analysis¹⁴, reviewing the US Troubled Assets Relief Program (TARP) found that “US banks with TARP funds have more independent boards, larger boards, more outside directorships and greater incentive pay for CEOs” and that “some of these results are consistent with the idea that TARP banks have worse governance”,

IFSA considers that membership of a fund is not determinative of a trustee acting in the best interests of members. While there may be some perceived advantage to the alignment of interests which occurs where the trustee is an investor in the Fund, there is no absolute need for it in light of the fiduciary obligations already attached to that office.

IFSA notes that the key principle is that the Board comprises competent individuals who bring independent judgement to the Board’s deliberations. However, while a perceived issue remains about the need for trustee independence IFSA recommends that governance requirements involving superannuation board composition and operation should be aligned with the requirements of Part 5C.5 of the Corporations Act. Those provisions require the establishment of a compliance committee with a majority of external (independent) members where the board of the responsible entity of a managed investment scheme does not have a majority of external (independent) members.

Recommendation 20: IFSA recommends that governance requirements involving superannuation board composition and operation should be aligned with the requirements of Part 5C.5 of the Corporations Act and that a compliance committee with a majority of independent members be established where the trustee board does not have a majority of independent directors.

¹³ Corporate governance and the financial crisis, Professor Steen Thomsen, Director for the Centre for Corporate Governance at Copenhagen Business School. Article in Investment, Risk and Governance , Steen Thomsen (first Edition 2009) by Casper Rose and Ole Risager.

¹⁴ Corporate governance and the financial crisis, Professor Renee Adams, Professor of Finance at UQ Business School. Article in Investment, Risk and Governance , Steen Thomsen (first Edition 2009) by Casper Rose and Ole Risager.

5.2.6 Reliance on outsourcing: In many cases, trustees engage third party experts to perform a large number of the functions of the fund. Have funds struck the right balance between internal and external expertise?

IFSA submits that superannuation trustees in the retail sector have struck an appropriate balance between internal and external expertise.

In any event, if a key function of a trustee is outsourced, the outsourcing standard in SIS regulation 4.16 will apply. That standard imposes onerous requirements on trustees and providers in relation to outsourced functions. Further, APRA has issued a prudential practice guide setting out its requirements and expectations in relation to outsourced functions and regulation 4.16.

As industry competition and advancements in technology drives higher standards and greater efficiencies, outsourcing can be a cost effective mechanism for maintaining industry best practice (see 5.1.6).

5.2.7 Conflicts in outsourcing: In outsourcing so many functions, how do trustees who are associated with a service provider manage the conflict that arises between the interests of members and their own or associated interests? What should the rules be where a trustee has a relationship (by way of employment, directorship or ownership) with a fund service provider?

Trustees who choose to outsource *many* functions need to satisfy themselves that the service providers carrying out these functions on the trustee's behalf are competent and appropriate to perform these activities.

See 5.2.1

5.2.8 Composition of the boards and succession planning: Around three-quarters of all trustees are male and over 50 years old. Some trustee directors stay in office a long time and others are trustees of more than one fund. What rules should there be around qualifications, length of time in office, multiple trusteeships and selection processes for trustees?

The role of trustee of a superannuation fund is a critical one. Trustees must manage the complexity of the fund, the ever changing legislation and oversee investment of fund assets. It is critical that members' benefits are governed by qualified and experienced trustees.

The level of training of trustees is important and goes to the issue of competency. Trustees are already required by APRA to keep training registers and training offered to trustee directors is a matter that APRA has regard to in its annual fund reviews. At a minimum trustee's should have a Company Director qualification. In addition, due to the complexity of superannuation there should be minimum industry experience or educational qualifications. These qualifications should be regularly updated with minimum training.

IFSA's view is that there should be no restrictions on tenure for trustee directors or the number of funds that they can act as trustee of over their careers. The length of

time in office and number of superannuation funds a trustee is irrelevant – in many respects tenure and corporate memory is an asset. Further, understanding the affairs of other superannuation funds can bring additional learning to the management of a fund. Conflicts across superannuation funds would be very rare and appropriately qualified and experienced trustees would know when to declare a conflict and not vote.

Recommendation 21: IFSA recommends against prescribing rules about the qualifications, length of time in office, multiple trusteeships and selection processes for trustees. The matter is one for the trustee board to consider as a whole having regard to their responsibilities to manage the fund in the best interests of members.

5.2.9 Stock lending: Should it be left to trustees to decide if it is in the interests of super fund members to have equity investments owned by the fund made available for the purposes of short-selling or hedging by third parties, or should this practice be regulated in some way?

Responsibility for decisions in relation to stock lending should remain with trustees.

Stock lending promotes liquidity in the capital market and provides an additional source of revenue for superannuation funds. According to ACSI, superannuation funds specifically undertake stock lending in order to earn additional income from the stock that they hold in conventional long portfolios. In this regard, superannuation funds typically lend securities to (or through) their custodians on a fully secured basis. They generally:

- lend a small percentage of their holding in any one stock for a relatively short period of time;
- provide for the recall of their stock for any vote required;
- preserve their rights to any dividends, franking credits, bonus issues or any other rights which might accrue to the stock during the loan period

A stock lending program, if implemented appropriately and professionally by a trustee, can enhance returns for an understood and acceptable level of risk and, therefore, be an activity that is appropriate for a trustee to pursue. The merits of stock lending were described in a paper presented at the 2009 Law Council Superannuation Conference as:

For the institutional investor (such as a pension or superannuation fund, an insurance company, public unit trust or other kind of mutual fund, and some government bodies), securities lending is widely viewed as a natural adjunct and value added service to the custody service provided by custody banks. Although the incremental income is typically relatively small (though it can be significant in absolute terms and reinvestment spreads on cash collateral have widened since the onset of the Global Financial Crisis), it offers the opportunity to the investor, *with limited risk*, to earn some incremental income and thereby effectively reduce their net custody fees. This is particularly relevant for a large portfolio, because it enables the institution to effectively provide a greater return for its clients¹⁵.

¹⁵ 'Securities lending by superannuation funds in Australia', John King, Partner, Mallesons Stephen Jacques (27 February 2009)

While we agree that superannuation fund engagement in stock lending should be very clearly disclosed to investors up-front, regulation should not limit the discretion of trustees in the performance of their investment management activities for the benefit of members.

Recommendation 22: IFSA recommends that the ability to engage in stock lending for the benefit of fund members should be left to the discretion of the superannuation fund trustee.

5.2.10 Consolidation: Should trustees of small funds be obliged to take steps to merge the fund in the pursuit of economies of scale in the long-term interests of members?

IFSA does not support trustees of small funds being obliged to take steps to merge in pursuit of economies of scale. Prescribing when a fund is no longer viable as a stand alone fund is a complex matter requiring the exercise of judgement of the trustee familiar with the funds' circumstances, and IFSA cautions against mandating criteria setting out when mergers should occur or mandating trustees to pursue mergers.

Government could consider extending CGT rollover relief further than recent capital loss relief for fund asset transfers and mergers, to enhance competition and efficiency.

Industry rationalisation

The superannuation industry experienced a dramatic rationalisation in the number of superannuation funds with the introduction of Registrable Superannuation Entity (RSE) licensing in 2004 and the Australian Financial Services Licensing (AFSL) regime in 2002. These policy reform initiatives indirectly encouraged merger activity through, amongst other things, requiring improvements in the conduct of trustee entities (and their directors) and the introduction of new operating standards. Due to increased compliance costs and the raising of professional standards generally, the economic viability of many funds was challenged. Many corporate funds elected to exit the sector rather than accept the additional responsibilities and cost burden of operating a fund under the new regulatory regime.

To illustrate the extent of rationalisation, prior to the introduction of the RSE licensing regime, approximately 1200 Trustees operated 9000 funds. At the completion of the licensing program in June 2006, these figures had decreased dramatically to 307 licensed Trustees operating approximately 6900 funds.

The benefits of rationalisation

In principle, IFSA supports further rationalisation of the superannuation industry. Rationalisation to date has, we believe, resulted in the following benefits:

- The raising of professional standards (eg in governance and in competencies of directors) achieved through regulatory reform has resulted in an improvement in the quality of trustee directors and therefore boards with an improved decision-making capability. This is important as trustees' decisions influence financial outcomes for members, and it has to date been the trustees' responsibility to consider the case to remain stand alone or to merge. Better quality directors are likely to make rational decisions in this area and less likely to make such decisions based on inappropriate considerations such as personal interest.

- Increased size of a super fund confers benefits of economies of scale, such as access to better group insurance policy terms and an improved capability to invest as an institutional investor (for example, to be able to afford better advice and access to investment opportunities).
- Members of some funds have benefited by the exit of some trustees whose lack of professionalism posed a risk to members' interests.
- Risks relating to members' interests in super funds are now better managed at the trustee level due to the risk management elements of the RSE licensing reform.
- APRA is better placed to carry out prudential oversight as there are significantly fewer entities for it to regulate.

There is evidence to support the benefits of economies of scale and the trend for super funds to seek greater scale by merging is soundly based for a number of reasons. Scale typically reduces administration costs providing the opportunity for cost savings through lower fees from investment managers and averaging of overhead costs.

How should rationalisation be encouraged?

IFSA considers that trustees should retain full discretion to consider the viability of funds they are responsible for. IFSA has pressed for more comprehensive tax relief in relation to successor fund transfers, as crystallisation of tax gains or losses is a significant factor for a trustee when considering whether such a transfer will be in the best interests of members.

IFSA supports competition in the superannuation industry and the retention of choice of fund. Contestability in the marketplace is a positive force acting in members' interests, through innovation in design of offerings to members and the pressure to improve investment performance and outcomes for members in a range of areas.

The impact of regulatory reform to date and market-driven initiative to drive rationalisation points to how further rationalisation may be encouraged. Policy reforms that centre on the raising of professionalism and the promotion of standards of conduct at both the trustee entity and the director level assist in promoting merger activity. Such reform is an indirect means of encouraging merger activity and preferable to imposing an obligation on trustees as this approach is paternalistic, constraining and diminishes the role of trustee directors. To impose such a constraint might discourage quality candidates from considering an opportunity to become a director of a small fund.

We note that it may be that a small fund with good quality directors is able to meet reasonable regulatory requirements and standards, and to deliver a competitive service tailored to its members. Such a fund ought to be able to continue to operate without being subject to an obligation to take action which may not be in the best interests of its members.

Product rationalisation should be facilitated by Government but should not be mandated.

Recommendation 23: IFSA supports the enactment of legislation that will facilitate product rationalisation across the superannuation, life insurance and managed investments industry. That legislation should address taxation and regulatory barriers to rationalisation.

IFSA does not support mandating the rationalisation of small superannuation funds.

5.3 Government and regulatory

5.3.1 Government policies: Because super is concessionally taxed, compulsory and otherwise facilitated by Government, should Government:

5.3.1.1 use the system to advance other policy objectives such as sustainability, corporate social responsibility and managing climate change;

5.3.1.2 be able to influence whether super funds make particular investments (eg infrastructure) either by directly mandating some level of participation (eg like a '20/30 rule') or providing strong incentives to do so; and

5.3.1.3 remove barriers (if any) preventing trustees investing in long-term investments, such as infrastructure? To what extent do these barriers exist? Are portability and the ability of members to switch between investment options inhibiting the ability of funds to make long-term investments? Should the Government have a role in reducing these barriers and, if so, how?

Superannuation regulation provides a sole purpose test to ensure that decisions taken by trustees in relation to both investments and operations are for the purpose of providing retirement incomes. This principle should remain immutable and apply to government in its regulation of superannuation.

Trust law does not permit trustees to be influenced solely by political or social concerns, but requires them 'to exercise their powers in the best interests of the beneficiaries'. The issue of whether superannuation fund savings should be utilised to promote broader societal objectives has previously been reviewed by the Parliament and we consider that nothing has changed that should result in a different response. Trustees must strike an 'appropriate balance between maximising the investment returns and minimising the exposure to risk of the monies under their control'.

Because superannuation is concessionally taxed, the sole purpose test should be used for the purpose for which the tax concession was provided. That is, to encourage the accumulation and growth of adequate private savings for retirement and to enhance their adequacy in providing a reliable post retirement income stream.

The reason that superannuation is compulsory is to overcome behavioural deficiencies which would otherwise inhibit the achievement of the accumulation of adequate retirement savings, and to provide a mechanism through the taxation power to provide for the collection of superannuation contributions from employers.

The short response to each of the matters raised is:

5.3.1.1 The Government has remained commendably restrained throughout the GFC in not directing use of superannuation funds to provide either liquidity or direct economic stimulus which would have disrupted investment strategies and involved additional risk. While they may in themselves be worthy, other longer term policy objectives equally involve a diversion away from the essential long term investment focus on providing the maximum level of retirement income for a given level of risk.

5.3.1.2 Mandating participation in particular investments or asset classes will reduce allocative efficiency and detract from productivity. In its most recent work on national saving IFSA had Econtech model an allocation of superannuation

funds to infrastructure and found that the resulting distortion of the market reduced economic growth¹⁶.

5.3.1.3 While many assets have appropriate growth and income characteristics which make them suitable long term investments to provide retirement incomes, direct investment in such assets may carry with them valuation, tax and liquidity risks which are incompatible with daily unit pricing. Additionally, the trustee must have regard to liquidity issues for the purpose of meeting immediate financial obligations to members and the operation of the fund (see Issue 5.1 in relation to liquidity and portability).

In order to encourage investment in Australian infrastructure, existing and prospective projects should be practicable and internationally competitive. We welcome further consideration of exploring options to reduce the costs of engaging with government (facilitated by the Commonwealth's Infrastructure Australia). Options include standardising policies and processes between jurisdictions (particularly between the States and the Commonwealth) and reducing transactions costs, including unnecessary costs incurred during the tender stage of PPP projects.

Recommendation 24: IFSA recommends that:

- (a) the role of trustees in acting in the best interests of their members be endorsed and that investment decisions be based solely of what is in the interests of the members;
- (b) decisions to invest in assets that have broader societal benefits be undertaken by the trustee only on the basis that such investments are directed towards maximising the financial returns to members and that taxation concessions by Government may feature in any such decision.
- (c) The appropriateness of longer term investments such as infrastructure investments be determined by the trustee on the basis of :
 - (i) the age profile of the members;
 - (ii) their risk tolerance;
 - (iii) the size of the fund;
 - (iv) its likely growth rate; and
 - (v) the need to maintain liquidity to meet immediate obligations of the fund.

¹⁶

The Economic Impact of Increased National Savings, Econtech, July 2008

5.3.2 APRA regulation: Should:

5.3.2.1 APRA have a prudential standard-making power or a power to give directions in relation to superannuation? If so, in relation to what prudential issues?

5.3.2.2 APRA's powers extend beyond prudential matters? If so, in relation to what aspects of superannuation?

5.3.2.1 and 5.3.2.2

The SIS Regulations contain operating standards to which trustees must comply. These standards give detailed guidance to trustees on the operations of their funds. The Government has driven many policy changes by means of amendments to the operating standards, for instance the changes that were made during the Simpler Super reforms.

It is IFSA's view that these operating standards, together with the SIS Act itself, are sufficient to govern superannuation funds and that a prudential standard-making power is not necessary. This is especially true as the vast majority of superannuation contributions are now invested in accumulation benefits, where prudential regulation in relation to capital and solvency has little role to play.

In practice, APRA issues guidance to trustees on a range of prudential matters (for example, guidance on risk management, capital, outsourcing, adequacy of resources and fitness and propriety). These guidance notes are effectively enforced by APRA on an 'if not, why not' basis. Failure to comply with the standards can lead to higher risk assessment by APRA and increased regulatory oversight. This can also lead to APRA investigations, banning orders and imposition of licensing conditions.

Giving APRA prudential standard making powers will add yet another layer of complexity to the legislative and regulatory framework.

Recommendation 25: IFSA does not support APRA having a prudential standard making in relation to defined contribution funds. This is the role of the Parliament and experience shows this power increases the complexity and overlap in regulation.

5.3.3 Sanctions and enforcement: Is the existing sanctions and enforcement framework applying to trustees' regulatory obligations appropriate? Should civil or criminal penalties (or both, depending on the severity) apply for breaches of the SIS Act covenants?

APRA and ASIC both have extensive investigative and enforcement powers. Given the relative stability of the superannuation industry and the small number of trustee

failures in Australia, IFSA is of the view that an increase in regulatory powers and penalties is not warranted.

The Review should also bear in mind that the fund assets are available to indemnify the trustees and its directors. Increased penalties may not be in the best interests of members, especially in the not-for-profit sector,

Disqualification orders, which have been used extensively by APRA in recent years, provide a significant disincentive to wrong-doing by directors. APRA also has the power to issue directions on a range of issues, including compliance with RSE licence conditions, which include the obligation to comply with SIS and other relevant legislation.

Recommendation 26: IFSA does not support any increase in sanctions and enforcement powers under SIS.

5.3.4 Related party transactions: A regulated superannuation fund is not subject to the regime governing related party transactions that apply to companies and managed investment schemes under the *Corporations Act 2001*. Is this a gap leading to practices that would not be permitted without member approval if the funds were subject to that regime?

The disclosure rules relating to superannuation entities should provide sufficient transparency so that contributors can make meaningful assessments and comparisons between funds on organisational structure and performance, operational efficiency and governance.

Public companies have a separate set of disclosure requirements under the Corporations Act. Given that the majority of employees can now choose which superannuation fund they want to manage their money, as far as is practicable, all trustees should be subject to the same disclosure requirements as public companies. This would include related party requirements of Chapter 2E of the Corporations Act and the disclosure requirements of section 711(3) of the Act in relation to a superannuation fund.

Unlike public company directors who are required to disclose the nature and value of benefits received for services provided, and persons named in a managed investment scheme product disclosure statement (**PDS**) who are required to disclose the nature and value of benefits received for services provided to the responsible entity, no such requirements apply in a superannuation context.

IFSA recommends that the disclosure requirements applicable to a public company should apply to the trustees of all superannuation entities. The law need **not** require the trustee of a superannuation entity to be a public company

To the extent that related party transactions may give rise to concerns about conflicts of interest, please see our comments at 5.2.1 above.

Recommendation 27: IFSA recommends that disclosure requirements applicable to a public company should apply to trustees of all superannuation funds. The law need not require the trustee of a superannuation entity to be a public company.

5.3.5 2007 PJC Inquiry: In August 2007, the Parliamentary Joint Committee on Corporations and Financial Services issued a report into the structure and operation of the Australian superannuation industry. The committee made 31 recommendations. The Review proposes to examine the recommendations of the committee that fall within its terms of reference and seeks feedback on the following recommendations relating to Governance issues:

Recommendation 4

3.35 The committee recommends that peak superannuation bodies and APRA continue to work with the Australian Accounting Standards Board with a view to forming appropriate compulsory accounting and disclosure by all funds for promotional advertising, sponsorship expenses and executive remuneration.

Recommendation 6

3.65 The committee recommends that trustees of superannuation funds publicly tender key service provision agreements.

Recommendation 4: IFSA supports the development of superannuation fund accounting and disclosure standards for promotional advertising, sponsorship expenses and executive remuneration.

Recommendation 6:

IFSA does not support a requirement for trustees to publicly tender key service provision agreements. Many trustees conduct tenders for key outsourcing roles, and it is a matter for the judgement of trustees how they are conducted. Some elect to seek the assistance of an independent expert in such cases, whilst others are satisfied with their own capabilities in tender management and do not seek external assistance. The sector has evolved in its professionalism to the point that there is not a significant problem concerning the appointment of third parties to supply key services.

A requirement to conduct public tenders would impose a very significant cost burden on all trustees and, in turn, their members, in circumstances in which it is far from clear that there would be a significant benefit for any particular class or category of fund. If there was merit in conducting public tenders from a cost / benefit perspective one would expect there to have been evidence of this occurring in the private sector to date but to IFSA's knowledge there has been very little, if any, such activity in that sector.

Recommendation 28: IFSA recommends that the public tender of key service agreements not be required. Market practice in this area is not deficient the exercise is not justified on a cost benefit basis particularly where there is an expectation from fund members that the trustee will engage related entities in the provision of superannuation services.

5.4 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 super fund members need a body or association that just represents them and advocates their issues? Also, members lack an annual general meeting equivalent. Should larger funds host, for example, online AGMs?

Are super funds, individually or as a class, sufficiently accountable to members?

The requirement that the governing rules of each superannuation fund contain the trustee covenants prescribed by section 52 of the SIS ensures that trustees of super funds are directly responsible and accountable for the prudential management of the benefits of their members. The requirement applies across the four major types or sectors: the corporate, public sector and industry funds ('not for profit' funds) and retail funds.

The conditions imposed on all RSE licensees to comply with a fit and proper standard, and the risk management plan of each super fund¹⁷, provide a strong and effective framework by which trustees meet their responsibilities to their members. In addition, the Australian financial services licence obligations imposed on the trustees of retail funds and larger 'not for profit' funds serve to raise the level of accountability to the members of those funds under their trusteeship.

The pre-licence vetting, by APRA, and the ongoing monitoring and supervision of super funds by APRA and fund auditors, and of trustees holding AFS licences by ASIC, are designed to ensure that funds are properly managed in a manner that appropriately safeguards members' interests. The detailed member disclosure requirements set by the Corporations Act and the Corporations Regulations provide members with regular information about the management and performance of their funds.

The primary interest of fund members relates to the accumulation of their retirement savings and investment in either the strategy or options selected (directly or indirectly) by the member. Members as a whole have little interest or involvement with the operation of the fund as a whole. The levels of member engagement do not justify provision for active member involvement in the operation of super funds beyond the exercise of individual discretions.

Annual general meetings are not required for managed investment schemes for the same reasons and should not be imposed on superannuation fund members. Such a requirement would not serve any useful purpose and would result in significant annual costs for fund members. Better, more targeted means of communication are currently used by large funds.

¹⁷ Finding 7, *The Governance of Superannuation Funds – the industry three years on from trustee licensing*, A joint report from the Institute of Chartered Accountants in Australia and Deloitte, 2008 noted: "78 percent of survey participants rated the quality of their risk management as excellent, or above average with the licensing regime hastening the exit from the industry of trustees who were unable to meet the higher expectations and the standards imposed."

How successful has the policy committee structure (Part 9 of the SIS Act) been?

It has been the experience of our membership that the success of the policy committee structure has declined with the increased complexity of superannuation.

The role of the policy committee is intended to act as a conduit between the members and employer-sponsor of a fund and the trustee. Key functions of the committee are to provide an avenue for members to inquire about the investment strategy and performance and the operations and performance of their fund; and for the trustee to obtain the views of fund members on their information needs.¹⁸

The basic equal representation rule and the member representative nomination process are intended to ensure that members interests are appropriately represented on the policy committee, and that member representatives are nominated in a fair and democratic way so that all members, including those in remote geographic locations, can participate in the nomination process.¹⁹ The policy committee is required to meet at least annually.

We note that since APRA Superannuation Circular No III.A.3 was reissued in 2000 the financial services reform legislation, RSE licensing, employee choice of fund and portability has significantly changed the manner in which trustees are now accountable to their members.

Enhanced disclosure requirements have provided members with detailed information about their fund's operations and performance. Under RSE licensing, the 'fit and proper' standard is designed to ensure the interests of members are managed and overseen competently by appropriately skilled, honest and trustworthy individuals. In administering the standard APRA has recognised as a reflection of the increased size and complexity of the industry over the period since implementation of licensing of trustees that the level of skills needed for a trustee to demonstrate adequate fitness has increased in most instances.²⁰

In contrast, the need for increased skill levels to deal with complexity of superannuation has had the following effects on the policy committee structure as experienced by our membership:

- Very few requests from member groups with 5 to 49 members to establish a policy committee;
- Increasing difficulty in getting members to nominate for the position of member representative, where the mandatory requirements for maintaining a policy committee apply; and
- Fewer elections being called due to the lack of member nominations.

Additionally, IFSA members have experienced instances where despite their best efforts, some policy committees have failed to meet at least once in a 12 month period due to competing employer priorities.

¹⁸ Regulation 3.06 Superannuation Industry Supervision Regulations 1994

¹⁹ See APRA Superannuation Circular No III.A.3 *Trustee Arrangements – Public Offer Superannuation Funds*, September 2000

²⁰ Paragraph 33, APRA Prudential Practice Guide Draft , *SPG 520 – Fitness and Propriety*, 14 August 2009

Recommendation 29: IFSA considers that:

- (a) member interests are protected under the trust structure and that the Superannuation Complaints Tribunal provides an appropriate venue for the determination of disputes relation to the operation of the fund or the exercise by the trustee of discretions.
- (b) AGMs or online AGMs would not be widely supported by fund members;
- (c) the public tender of key service agreements not be required.

Market practice in this area is not deficient the exercise is not justified on a cost benefit basis particularly where there is an expectation from fund members that the trustee will engage related entities in the provision of superannuation services.

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?

Corporate Governance

As major shareholders, IFSA members are in a position to promote improved company performance that provides positive benefits to all shareholders and the economy as a whole. While shareholders are not involved in the day-to-day management of companies, the Corporations Act, ASX Listing Rules and industry best practice provide many opportunities for shareholders to monitor and influence company decision-making which drives ultimate company performance.

IFSA's Guidance Note No. 2 - Corporate Governance: A Guide for Fund Managers and Corporations (IFSA's Blue Book) is published by IFSA to assist fund managers and corporations pursue an active role in monitoring the Corporate Governance responsibilities of the companies in which they invest. IFSA's Blue Book was launched in 1995 and has become widely accepted by the investment and corporate community as providing guidance for corporate governance in Australia.

In order to promote communication between fund managers and companies in which they invest, Guideline 2 of IFSA's Blue Book prescribes:

Fund Managers should establish direct contact with companies in accordance with their Corporate Governance Policy. Engagement with companies should include constructive communication with both senior management and board members about performance, Corporate Governance and other matters affecting shareholders' interests.

Further, IFSA's Blue Book remarks that direct dialogue will give Fund Managers a better appreciation of a company's objectives, its potential problems and the quality of its management. Communication also provides the company with an opportunity to understand the expectations and concerns of professional investors. Two-way communications between companies and Fund Managers is an important aspect of

Corporate Governance, enabling each party to more fully assess the concerns and prospects of the company.

IFSA research reveals a very high level of direct contact between Fund Managers and companies. Fund Managers generally agree that direct contact is the most effective means of influencing Corporate Governance outcomes.

IFSA's Proxy Voting Standard

We strongly believe that in the area of shareholder engagement, IFSA members lead the way. Since 1 January 2005, it has been mandatory for IFSA members to comply with IFSA Standard No. 13 - Proxy Voting. Under Standard No. 13, IFSA members are required to vote on all resolutions regardless of the 'materiality' of a resolution or of the size of their shareholding.

More specifically, Standard No. 13 requires retail public offer schemes to publish, at least annually, an aggregate summary of their proxy voting record using the IFSA table prescribed in the Standard.

The Standard also requires schemes to have a formal Proxy Voting Policy setting out the principles and guidelines under which proxies are voted. This policy must also be made available to scheme members – with many such policies publicly available on IFSA member websites.

Obligations of the Trustee – Acting in best interests

IFSA recognises the primary importance of acting in the best interests of members but also acknowledges that the smooth operation of managed funds cannot be achieved where a high proportion of the unit holders do not exercise a vote.

We believe where possible, trustees should (and are legally obliged) to consider the interests of their members where votes are requested and exercise their votes accordingly.

Recognition should be given to the fact that on some occasions it may not be possible for the trustee to properly determine the impact on individual members of voting in a particular manner (eg where the members tax individual circumstances mean that members interests are served differently), and on these occasions it may be appropriate to abstain or to canvas the views of individual members. Such an approach is consistent with the current system of member investment choice within super.

It is the role and duty of a trustee to represent the interests of its members in relation to corporate governance matters, and many trustees have elected to discharge their duty by formulating investment policy and actively engaging with investment managers to ensure that appropriate attention is given to corporate governance at companies invested in. To this extent, members already have a say in the conduct of investee companies and this trend is expected to continue. Larger, more sophisticated, funds in particular are increasingly active on behalf of their members. Whilst there are challenges in this aspect of superannuation there are grounds to expect further improvement in terms of engagement.

IFSA does not support the imposition of any regulatory requirement that would be inconsistent with, or that would extend further than, current best practice.

Recommendation 30: IFSA considers that in the management of fund assets is properly the responsibility of the trustee. The role of the trustee is to seek to maximise the return to members. Issues of governance of assets in

which the trustee is invested on behalf of members is secondary to that purpose. IFSA recommends the maintenance of the status quo.

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?

The SIS Act sets out the requirements a trustee must take in selecting investment strategies and making those available to members – a trustee must have a process in place to ensure the investment option or strategy meets the requirements of the trust deed and is appropriate for its member base as a whole. It also has an obligation to continue to monitor and review those investments.

Member investment choice is fundamental to individual superannuation members exercising control over their retirement savings and asset allocation. Trustees should strongly encourage members to get advice before making key decisions that may materially impact their retirement savings outcomes. Trustees cannot control the advice process nor the behaviour of members and are not responsible for individual member decisions directing a particular investment regardless of whether personal advice has been received in connection with an investment direction.

Trustees should educate members on the choices and risks relating to them, and encourage the seeking of personal advice as noted above, however there must be a reasonable, sensible and practical limit on the responsibilities of trustees in this area.

Member Investment Choice is a critical component of the modern superannuation system, members must be given the ability to select a range of investment options that will meet their long term saving goals.

Background

Investment choice under sections 52(4), 58 and regulation 4.02 has been a part of the SIS regime since enactment of the legislation. It is not a new concept and, when combined with rapid technological advances in the 1990s and greater administrative efficiencies, it created the framework for the development and rapid growth of superannuation administration platforms that are offered mainly through licensed investment advisers. The fact that SIS does not refer to investment advice or reflect the contribution of investment advice makes to retirement savings through superannuation is a deficiency in SIS which should be addressed as part of this Review.

The original scope and limitations to superannuation investment choice were outlined by APRA in Superannuation Circular No.II.D.1 issued in April 1999 (**the Circular**). That Circular provided guidance to trustees on their responsibilities for managing fund investments and beneficiary choice of investment strategies under SIS. In the context of asset diversification and trustee discretion we note, in particular, paragraphs 18 and 50 of the Circular (emphasis added):

18. **There may be occasions where a trustee having taken into account all of the necessary considerations (including the need for diversification) invests all assets of a fund in a single asset class or even a single asset.** This would be unusual given contemporary risk and portfolio

management theories, which emphasise the risk of the entire portfolio rather than each investment in isolation.

50. Where investment choice is offered, members can select from the available range of investment strategies **to produce a tailor-made portfolio that meets their individual needs**. Trustees are not responsible for the actual strategy/ies a member may adopt provided all the requirements for choice of strategies are complied with (refer paragraphs 53 to 59) and each investment strategy offered has been properly formulated and implemented (see paragraphs 13 to 38).

SIS requirements

SIS Section 52(2)(f) provides that the governing rules of a superannuation entity must include a covenant to the effect that the trustee **must formulate and give effect** to an investment strategy that has regard to the whole of the circumstances of the entity including, but not limited to, the following:

- (i) the risk involved in making, holding and realising, and the likely return from, the entity's investments having regard to its objectives and its expected cash flow requirements;
- (ii) the composition of the entity's investments as a whole including the extent to which the investments are diverse or involve the entity in being exposed to risks from inadequate diversification;
- (iii) the liquidity of the entity's investments having regard to its expected cash flow requirements;
- (iv) the ability of the entity to discharge its existing and prospective liabilities.

The requirements of section 52(2)(f) are directed at the trustee in its management of the superannuation fund and do not permit member investment choice. The obligations for the formulation of an investment strategy and asset diversification are provided in the context of the superannuation entity as a whole (ie not at the individual level) and are intended to ensure that the trustee is able to meet cash flow requirements and discharge liabilities.

Member investment choice is permitted through section 52(4) and regulation 4.02. SIS Section 52(4) provides:

An investment strategy is taken to be in accordance with paragraph (2)(f) even if it provides for a specified beneficiary or a specified class of beneficiaries to give directions to the trustee, where:

- (a) the directions relate to the strategy to be followed by the trustee in relation to the investment of a particular asset or assets of the entity; and
- (b) the directions are given in circumstances covered by regulations made for the purposes of this paragraph.

In other words, subject to satisfying the regulations, a trustee is deemed to have satisfied its obligations under section 52(2)(f) where member investment choice is offered. It should be noted that for legal purposes, section 52(4) does not modify section 52(2)(f), it satisfies the covenant in its entirety. That is, where member

investment choice is offered, member direction satisfies the obligation of the trustee to **formulate and give effect to** an investment strategy for the fund. At paragraph 31 of the Circular, APRA states:

The investment covenant prescribes that a trustee must formulate and give effect to an investment strategy. Giving effect to (or implementing) the strategy is thus a separate process from formulating the strategy. Implementation of the strategy involves considerations such as the quantum of fund assets, the expertise of the trustees, the availability of appropriate advice, administrative capabilities and the costs of managing investments. It may involve direct investment, indirect investment (eg. through collective investments), using investment managers or a combination of these approaches.

We repeat that member investment choice under SIS is deemed to satisfy the obligation of the trustee to formulate and give effect to the investment strategy required under section 52(2)(f). Both section 52(4) and regulation 4.02 rely on information and disclosure.

Investment choice

Platforms provide the 'infrastructure' (reporting, trade execution, custody etc) for advisers/dealer groups to implement and run investment strategies for their clients that take account of their overall financial position, including other superannuation accounts they may hold and their non-super investments. Advisers/dealer groups have statutory responsibilities to know their clients financial position and goals and are able to utilize the superannuation investment platform as an efficient 'execution/maintenance tool' for the superannuation component of their clients' overall investment strategies. The advisers and dealer groups are also licensed by ASIC in relation to the financial services that they provide and are authorized to provide under their Australian Financial Services Licence.

Members of retail superannuation funds (who are generally advised) require a good range of investments for the implementation of a robust retirement income strategy. One of the largest retail superannuation platforms in the market reports that its 'Moderate' investment option (generally considered to be the default investment option for many members) only holds approximately 5% of the product's funds under management. This infers that around 95% of investors avail themselves of investment choice by choosing other investment options (often multiple investment options) on the platform.

The evolution of large investment menus on platform products (a typical investment menu includes over 100 investment options) is simply the result of superannuation funds responding to the demands of users as efficiently as possible. These users are generally members who invest as the result of a recommendation from their financial advisers and the advisers themselves. An important point to note when considering the level of choice available to members is that these products (retail platforms) are only used by 'direct' investors in a minority of cases. For example, for the same large retail platform provider mentioned above, approximately 90% of its investments are sourced through financial advisers.

However, in order to understand why the demands of financial advisers and their clients result in the construction of large investment menus it is important to understand what goes behind the financial planning and investment selection process.

Financial advice is a competitive marketplace. Each dealer group (financial advisory network) generally conducts its own research on products and investments, with the aid of research houses, in order to design their own approved list. This list is referred to by advisers in the process of making investment recommendations to clients in the implementation of personal financial product advice. The advice process includes taking into account the particular circumstances and preferences of the client/member (including their investment profile) and tailoring a solution which is specifically designed to meet their needs. It follows that in order to be able to cater for the needs of multiple dealer groups, advisers and members, and remain competitive in this marketplace, a wide range of investment options is necessary.

If only a very limited menu of options was permitted, sub-optimal investment advice would result. Alternatively, financial advisers would be required to undertake a very inefficient and costly process of accessing multiple investment options across multiple products. Again, this would be likely to result in poor member outcomes.

To address their statutory obligations for the provision of advice to clients, advisers/dealer groups generally establish investment committees for the purpose of conducting due diligence on managed funds and listed securities (this also involves looking at rating agencies) for possible inclusion in their recommended investment strategies. The 'model portfolios' developed by dealer groups are designed to provide investors with a properly structured portfolio and exposure to certain asset types. In some instances these models may not be able to be implemented in full due to limit restrictions in super.

Some IFSA members offering superannuation platforms have experienced significant negative comment from advisers and dealer groups regarding investment limits in Super (for managed funds and listed securities) where the trustee requires them to be applied. **There is a strong consensus across the adviser community that the fund trustees and platform providers are not in a position to know what is / is not a good investment for their individual clients, as they are not aware of individual client financial positions and strategies, and will never know what they are.** On the other hand, advisers know the financial circumstances of each of their clients, as required under the law, and advise them accordingly on their investment selections and strategies. Under the member investment choice model permitted by the law, portfolio construction is the responsibility of the member and investment selection usually involves the allocation of investments across the asset classes of cash, fixed interest, shares and property according to the client's risk tolerance and investment time frame.

Standard portfolio construction, determined across the fund membership based on various factors including age, remains appropriate for super fund offerings that do not offer member investment choice. Standard portfolio construction is, however, wholly inappropriate to superannuation platform structures that make multiple investment options and strategies available to members who have their own financial advisers to help and advise them regarding their investment selections.

Superannuation industry developments and increased efficiencies have been made in response to the recognition by Government of the importance of superannuation to Australians, and the need for a regulatory structure that will facilitate the maximisation of superannuation returns to members. As part of this scheme, Government consciously moved away from a paternalistic approach to superannuation by shifting a considerable degree of responsibility for superannuation savings to members, placing a focus on the education of members, and enhancing the regulation of advice and advisers.

IFSA considers that the regulatory arrangements introduced by Government for investment choice, in both superannuation and non-superannuation products, are primarily disclosure based. Based on our understanding, the **prudential obligations** of a trustee involve having in place appropriate systems to:

- **Formulate and document** one or more investment strategy(s) which may be quite broad or very narrow, depending upon the type of fund and number and range of strategies on offer;
- **Manage** those investment strategies in a prudent manner (eg. obtaining appropriate and timely valuations and updating unit price/asset earnings attribution, equitable expense, including tax liability, allocation etc);
- **Acquire, redeem and report** on investments offered and selected by members in accordance with what has been disclosed.

A trustee unilaterally interfering with selections made by a member from within an offered strategy (by limiting exposures or "rebalancing") would in fact be acting in contravention of its obligations to members under the member investment choice arrangements currently operating. The risk of litigation if such actions were to lead to loss and/or create over or under-weight exposures in the context of the individual's own objectives, financial situation and needs²¹ is clearly high and untenable within the context of existing practices. Additionally, for trustees to have to introduce mechanisms to limit members' strategy choices and automatically rebalance members' accounts will impose a huge and unwanted cost burden on the industry, and may lead to a restructuring of superannuation arrangements as members seek to preserve their current investment choice entitlements.

Recommendation 31: IFSA recommends that:

- (a) SIS be amended to make clear that while a SIS trustee is responsible for providing suitable investment strategies to fund members, it is not responsible for individual member investment choice within those strategies;
- (b) SIS be amended to clarify the operation of the relevant SIS provisions by:
 - (i) expressly providing a carve out for trustee responsibility from policing asset diversification where member investment choice is provided;
 - (ii) recognise that asset diversification limits are a discretionary matter for each trustee having regard to its assessment of the risk and return characteristics of the investment choices provided in their product offerings;
 - (iii) expressly recognising the trustee, in the performance of its fiduciary responsibilities to members, should be able to take into account factors such as role of advice or members' direction/choice in a superannuation context .

²¹ The Corporations Act recognises that individual circumstances are vital to the selection of any particular financial product as it requires an investment adviser to give reasonable consideration to a client's "objectives, financial situation and needs" when advising the client about **any single financial product**. Clearly, superannuation is a financial product. In this regard, the Australian Securities and Investments Commission (ASIC) is responsible for regulating disclosure, consumer protection and member complaint provisions under the SIS Act and Corporations Laws.

5.5 Operational

5.5.1 Investment Time Horizon: It is often said that superannuation funds and investment managers are too focused on short-term performance. Is this criticism valid and, if so, what are the factors driving short-termism and what, if anything, could be done to encourage a longer-term horizon?

Investment time horizons are typically long, whether superannuation is in the accumulation or retirement phases. Tolerances for volatility are, however, much lower as fund members approach retirement and in the pension phase. High volatility events close to retirement can have a significant impact on the size of retirement benefits.

There is an inherent difference in tolerance to volatility in the pension and accumulation phases. In the accumulation phase both income and capital gains are reinvested. Given a long enough investment horizon recovery from an adverse market event can be expected. However, in the pension phase, recovery from significant adverse market events is made much less likely because both income and capital are being consumed to provide retirement income.

The focus of investment policy needs to be moved away from time horizons and average outcomes to volatility, expected performance and lifetime need.

5.5.2 Tilt towards equities: Australian super funds seem to have had a bias towards equities in their portfolios (around 57 per cent before the global financial crisis, compared with an average of 36 per cent in 20 OECD countries where data are available). This meant that Australians' superannuation savings were more vulnerable to the global market turmoil, but equally are likely to benefit from a market recovery. Is this tilt towards equities justified? Should the Government impose restrictions to enforce more diversification to other asset classes or allow trustees to decide?

Adverse market events are inevitable and superannuation fund members are likely to suffer several adverse events over the course of their lifetime as both retirement savers and pensioners. The preference to equities is reflective of the long-term nature of superannuation as an investment and indeed the maturity of the defined contribution system in Australia. Generally equities have performed well when looking at longer time horizons. Investment in equities also provides funds with a strong liquidity position.

Research of Watson Wyatt found that Australia's large superannuation funds grew at the fastest rate among their global peer group over the last five years, despite making up just 2 per cent of the assets of the top 300 global pension funds. This is as a result of a large allocation to equities in these funds.

While an adverse market event early in working life will only have a small impact on retirement outcomes, the implications of adverse events become increasingly significant as fund members age. In relation to service offerings of trustees, and product design considerations, there is a case in favour of asset allocations needing to change over a lifetime to take account of the increasing impact over time of adverse market events on a fund member's retirement outcome. Trustees need to consider the appropriateness of default asset allocations for their members.

It is important to note that one reason for the bias to Australian equities is the significant tax benefits arising from the imputation regime. As trustees are focussed on maximising after tax wealth for their members, the tilt to Australian equities is not surprising.

In Australia superannuation investors have choice. In many cases some investors would like a very aggressive fund that had 90% equities. These would typically (but not always) be those persons with a very long term investment horizon e.g. 20 years plus. Other investors who are at or close to retiring may be more focused on capital preservation and, therefore, choose a more conservative investment option with say only 25% equities. A case can be made for asset allocation restrictions being placed on default options but not in a member investment choice scenario – see Issue 5.4.3.

Recommendation 32: IFSA recommends that asset allocation restrictions be considered for individuals invested in the funds default option.

5.5.3 Portfolio rebalancing: How rigorously do super funds adhere to their portfolio rebalancing policies? What are members told about this? Should there be clearer rules about how far out of balance familiar types of portfolios (eg balanced, growth) can go before some action has to be taken; for example, some prescribed ranges?

Practices vary and rebalancing within established ranges is generally managed well by trustees given the implementation challenges they face (for example, fluctuations in valuations in asset classes exposed to, which alter physical exposure levels).

Members are typically not informed of ongoing rebalancing activity. The vast majority would not understand the complexity involved nor arguably is it a matter that is important to them as rebalancing is a short term activity.

It is a matter for trustees to determine asset allocation ranges and tolerances and their rebalancing policy and approach. Given the complexity involved IFSA does not support the creation of rules specifically to address rebalancing, and IFSA reiterates its view that it is not appropriate for regulation to constrain the ability of trustees in relation to their portfolio management activities.

Guaranteed income streams can be expected to outperform bond funds as the defensive component of an asset allocation, for any split between defensive and growth assets. This outperformance of guaranteed income streams as defensive assets results from the effect of the guarantee in removing risk, the investor sharing part of the liquidity premium, and access to the equities risk premium from an increasing allocation to the growth component if the total portfolio is not rebalanced.

Trustees should typically be adhering to the stated strategic asset allocation (SAA) ranges with a margin or prescribed ranges to allow for tactical or just market price shifts. Some managers have quite aggressive shifts in tactical asset allocation (short term changes < 1yr) while others do what is known as dynamic asset allocation which is medium term shifts (3yrs) in SAA. Others are very passive and allow for drift in the value of the asset classes as prices vary but rebalance back to the stated SAA on a regular basis, say every quarter or if it drifts say more than 2% away from the stated SAA. To rebalance everyday is too costly for investors.

One issue that has arisen recently is that those funds that hold illiquid assets such as direct property can see a marked /unintended shift away from the SAA weightings. Because of that illiquidity they are unable to rebalance quickly and the trustees simply ratify the positions and adjust them in the future on a best endeavors basis.

Investors should be told about these issues as their long term investment objectives may or may not be met if trustees do not follow the stated SAA ranges.

A further issue is the lack of consistency in definitions within the industry. Managers can have different asset allocations for funds with the same name. This 'true to label' issue has been identified by the industry and raised with the regulators, particularly in relation to comparative fund performance. The development of consistent naming/labelling for the various commonly used portfolios (e.g. balanced and growth investment options) is an important requirement for comparative purposes. IFSA would welcome further discussion with the Panel on developing such definitions and labelling.

Recommendation 33: IFSA recommends that portfolio rebalancing strategies be clearly disclosed to members and that the naming of asset allocations within particular ranges be standardised.

5.5.4 Leverage: Are the current exceptions to the borrowing prohibition suitable? Should superannuation funds be permitted to make investments that can result in investment losses beyond the initial capital outlay (such as instalment receipts or contracts for difference) even if they do not involve borrowing?

It is critical that a superannuation fund not incur losses to a greater extent than the capital the fund invests. While all investments carry a degree of risk and assets can go to zero, it is not appropriate in superannuation for the liability of a fund to exceed its assets. Such a situation would create a level of speculation and risk taking that is not appropriate when dealing with members' retirement savings.

It is equally important that superannuation funds are allowed to borrow for the effective running, operation of the fund, and in addition to enhance investment returns within acceptable risk limits.

The current borrowing provisions and, in particular, the relief given around instalment warrants are appropriate as they allow investors to access growth assets and enhance investment returns which would otherwise not be possible. There is also appropriate downside protection in that the ultimate risk is borne by the issuer. We believe that the relief can be extended to other types of borrowing where the downside risk is protected.

5.5.5 Tax governance: To what extent do trustees take an interest in the taxation of the underlying portfolio and, for example, the amount of capital gains tax being incurred? Crystallising capital gains in the accumulation phase can be adverse to members' interests, but will be unavoidable in certain circumstances and for certain types of funds. What are members (or their professional advisers) told about the tax governance policies of the fund? Is mandating an across the board obligation to have regard only to after-tax returns (eg in rewarding managers) a solution?

This question raises two issues: firstly, tax governance and secondly, the role of tax in investment decision making.

Tax governance

All trustee boards understand and pay attention to their tax governance obligations. They want to ensure that:

- all relevant reports are sent to the ATO e.g. member contributions statement reporting and TFN reporting;
- tax returns and BAS are prepared correctly and submitted on time;
- PAYG instalments are deducted correctly from ETPs and relevant pensions and remitted to the ATO correctly;
- PAYG instalments of income tax are correctly remitted to the ATO;
- for funds with unit pricing, that the prices correctly reflect incurred and anticipated tax liabilities; and
- for funds with crediting rates, that the rate declared properly reflects any actual or anticipated tax liabilities arising in the period.

Depending on the superannuation fund involved, there may be formal documentation of procedures in respect of some or all of these matters and external review of the calculations and processes.

IFSA's observation is that these tax governance standards are not easily met – they require superannuation funds to pay attention to tax outcomes and commit tax and operational resources to manage the fund's tax affairs. In recent years, superannuation funds have made a concerted effort to improve practices around the estimation of tax liabilities in unit prices or crediting rates. This has required superannuation funds to improve their understanding of how fluctuations in investment performance affect the tax liabilities of different superannuation fund investment options. This illustrates how tax awareness is increasing and tax management practices continue to evolve, without the need for mandated solutions to be imposed upon the superannuation industry.

IFSA also notes that mandating an after-tax focus will create additional compliance costs for superannuation funds, both one-off and ongoing, which could potentially be significant. This runs counter to current initiatives to reduce fees within superannuation funds.

Tax in investment decision making

IFSA understands that the primary role of superannuation fund trustees is to obtain good asset allocation advice, source skilled asset managers and ensure that these managers construct and manage portfolios within each asset class which are appropriate to the risk and return objectives of the superannuation fund. The superannuation fund will then normally construct a "value chain" of suppliers to deliver these objectives to the superannuation members, including the asset manager, custodian, asset consultant and superannuation fund itself.

There is a threshold question – not easily answered - as to where tax should be managed in this value chain; that is, who has the skills and information required to manage and report on the tax outcomes of investment decisions. Embedding a full tax awareness and reporting responsibility within an asset manager is, in IFSA's view, a respectable ideal, but one which many superannuation funds would find difficult, complicated and expensive to implement in practice.

Most superannuation funds set risk and return objectives for their asset managers which are based on pre-tax parameters. That is, trustees do not formally ask managers to manage the tax outcomes of their investment decisions. Trustees evaluate and remunerate their investment managers purely on the basis of the

economic decisions they make. This is an informed decision based on legitimate conclusions such as:

- the asset manager does not have the skill to manage on a tax-aware basis;
- the tax information is not available to the manager and is too costly to provide relative to the benefits (tax savings) which could be delivered, particularly given that superannuation members in the pension phase are in a zero tax environment and members in the accumulation phase are in a low tax environment;;
- tax aware investing may expose the superannuation fund to unacceptable tax risks;
- most of the value of tax-aware investing can be extracted from decisions outside of the asset manager's mandate, such as the superannuation fund's choice of investment structure, tax lot selection methodology (eg FIFO) or preference for passive (low turnover) rather than active investment strategies;
- after-tax investment outcomes cannot, or cannot easily, be objectively measured and benchmarked; and/or
- after-tax reporting requires numerous assumptions to be made which, at best, lack industry consensus and, at worst, create a risk that the output is misunderstood and misleading to superannuation fund investors – refer to a worked example below, calculating after-tax returns of 19.55%-21.35% on the same portfolio, depending on the assumptions made..

Worked example: Super fund Australian equities portfolio												
		Pre-tax return	Effective tax					Post-tax return				
			A	B	C	D	E	A	B	C	D	E
Value 1 July 2010	10,000,000											
Value 30 September 2010	12,000,000											
Income/gains	2,000,000	20.00%	-1.35%	0.45%	-0.15%	-0.87%	-0.30%	21.35%	19.55%	20.15%	20.87%	20.30%
Break down - all reinvested:												
Fully franked dividends - cash component	700,000											
Realised net capital gains - non-discount	100,000											
Unrealised net capital gains	1,200,000											
	2,000,000											
Assumptions:												
A: Current tax liability measured only (ie pre-liquidation)												
B: Current and deferred tax liability measured; apply CGT non-discount rate to unrealised component												
C: Current and deferred tax liability measured; apply CGT discount rate to unrealised component												
D: Methodology C plus deferral discount to 40% of unrealised component (based on projected turnover)												
E: Methodology C plus application of \$100,000 realised capital losses from another capital portfolio												

All of the matters listed above are important concerns which would need to be resolved in order for a mandated after-tax investment management focus to deliver value to superannuation fund members.

Awarding pre-tax investment mandates to asset managers does not mean that there is no management of the tax outcomes of investment decisions by a superannuation fund. Rather, it reflects the trustee's decision to build a set of tax management practices around, rather than within, the investment portfolios for the reasons discussed above. Superannuation fund trustees ensure that these tax management

practices conform at least to the minimum tax governance standards which, as discussed above, are not low.

Superannuation funds who do not share these concerns are able to delegate after-tax investment management responsibility to an asset manager, custodian or other supplier in their value chain. A small number of superannuation funds have done this and their demand for a tax-aware investing solution is being met in various forms by asset managers and other suppliers. For example, a few active managers offer fully customised single sector after-tax mandates (and one has multi-sector capability), while some passive asset managers (indexers) now report after-tax returns each year to investors, enhancing their positioning of index investing as a low cost after-tax investing solution. Elsewhere in the value chain, some custodians offer a whole-of-portfolio tax optimising and reporting service (“propagation”) to superannuation funds and some technology providers offer – at a cost – after-tax benchmark calculations which are highly customised to the particular superannuation fund client. A very recent development is the launch of the ASFA co-branded FTSE Australian equities index series which calculates Australian equity benchmark returns on a (limited) after-tax basis at a superannuation fund’s tax rate.

IFSA is pleased to see this evolution of the debate around the extent to which asset managers (and others) should deliver and report on after-tax, rather than pre-tax, investment outcomes. IFSA made an important contribution to this debate in July 2008 with its launch of an industry-wide methodology for calculating and reporting after-tax returns for investments into pooled distributing trusts.

As a result, an increasing array of management and reporting options are becoming available to superannuation funds wanting new tools to manage their investment tax outcomes. IFSA’s strong view is that this evolution should continue, without a mandated solution being imposed upon superannuation funds, to allow industry thinking to develop further and alternative solutions to be explored around how best to manage after-tax superannuation returns. Funds will then be able to form – as some are already doing - their own educated conclusions about whether current tax management practices are adequate, how and where else tax could be managed, the relative merits of the different after-tax investing approaches, the costs involved and how to measure and benchmark the results of an after-tax investment focus.

IFSA would like to make one final observation in recognition of the complexity of after-tax management and reporting. There would be a very real risk to superannuation funds if an after-tax focus is mandated prematurely; that is, before trustees precisely understand what it is they would value and are able to choose between a range of alternative solutions in the market; and before suppliers have fully developed this range of alternatives. The risk is a flight to one of two extremes: *either* a complex, over-engineered after-tax management and reporting solution where the cost outweighs the benefit for a superannuation fund; *or* an overly simplified response which (for example) reallocates investment exposure from fixed income to Australian equities to access franking credits and CGT concessions for superannuation funds. The events of the last eighteen months have shown how the latter approach might broadly have been branded “tax-effective”, but would have eroded value (pre- and post-tax) from superannuation accounts. Broadly, there should be no mandated approach to after-tax investing without having the comfort that superannuation trustees would be able to access “best of breed” solutions to meet the obligations of an after-tax mandate.

Recommendation 34: IFSA recommends that best industry practice be allowed to evolve in after tax reporting.