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Submission to the Exposure Draft Superannuation Legislation Amendment (Transparency Measures) Bill 2015

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1. Background

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

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

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

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

The Superannuation Legislation Amendment (Transparency Measures) Bill 2015 seeks to implement some of the measures recommended by Cooper.

2. Overview of this submission

2.1 The principle at stake

The money deposited in APRA (Industry/Retail) funds is money compulsorily taken from Australian workers (through lower wages) and held in funds where the workers have extremely limited control over what happens to their money. Because of the compulsory nature of the contributions and the minimal control workers exercise over their own money, the requirements for disclosure on the funds should be of the highest standard, higher even than those required of listed companies and arguably even higher than those required of government. There can be no excuse or justification for the current state of secrecy. Yet there is zero disclosure required at law.

2.2 What the Bill seeks to do

The Superannuation Legislation Amendment (Transparency Measures) Bill 2015 seeks to increase disclosure in two ways—namely, the introduction of requirements for

- *Portfolio holdings disclosure (PHD)*
- *Choice products dashboard*

Dashboard: This submission is not focused on the Choice Products Dashboard. The dashboard merely requires disclosure of a basket of a fund's products and their comparative performance to assist consumers to select where they park their money. The dashboard is not intended to enable forensic analysis of a fund's actual performance or behaviours related to the use of funds.

Portfolio holdings disclosure (PHD) This submission is interested in the PHD because this is the first time that actual disclosure would be required.

2.3 The current Bill is inadequate

The Bill is inadequate for two primary reasons

- There is no requirement to disclose the expenses of the funds or entities that manage the funds money.
- The limitation of disclosure to 'associated' entities will enable money to be hidden and removed from the disclosure requirements. The associated entities provision creates an 'open stable door' from which the 'horse' (money) can bolt.

2.4 Recommendations

The Bill should be expanded to

- a) Require disclosure of all expenses.
- b) Delve deeper to capture certain levels of 'non-associated' entities in the disclosure net. (See discussion below.)

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

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

3. Background disclosure reviews

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

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

4. The Cooper Report; Disclosure recommendations

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

The Australian superannuation system is characterised by a lack of transparency, comparability and, consequently, accountability. There is no standardised methodology for calculating and disclosing relevant fund or investment option information. Members often rely inappropriately on historical investment return data which gives no information about the risk attaching to those returns.

The Panel proposes measures, including:

1. development by APRA (in consultation with ASIC and the industry) of outcomes reporting standards aimed at standardising the way in which performance and costs are reported;
2. a new forward-looking risk and return matrix complemented by disclosure for investment options in a user-friendly 'dashboard' style;
3. disclosure by trustees of all costs incurred by the fund, to at least the first non-associated entity level, classified into 'cost categories' for the purpose of benchmarking and improving fund efficiency and performance;
4. all past investment return information must be accompanied by information about its volatility and be stated net of all costs and after tax; and
5. a government website (www.super.gov.au) to be developed, displaying superannuation information and resources to enable Australians to understand and navigate Australia's superannuation system more effectively.

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

** Each of the 20 Cooper Report recommendations should be fully implemented. The Superannuation Legislation Amendment (Transparency Measures) Bill 2015 should be reviewed and amended to ensure it includes each of the Cooper Report's disclosure recommendations.

5. The Self Managed Super Fund Alliance <http://www.smsfalliance.com.au>

The SMSFA has been an effective advocate for self-managed super fund owners. It has an interest in APRA funds because SMSFs often look to invest in APRA funds. In commenting on APRA funds' disclosure, the SMSFA has said

In particular, financial planners and other advisers to SMSFs need access to such information so they can confidently advise their SMSF clients on managed investments as one of the options open to them.

Specifically

Financial statements should show:

- * How trustee companies and funds earn revenue, identifying all sources:
 - fees and charges to fund members (identifying administration charges and percentage fees on funds held in the account)
 - any fees taken by a fund from investment income before striking a unit price

- income derived from the unit price spread (the difference between the buy and sell price of units)
- any fees, commissions or other payments related to life and permanent disability arrangements with external insurance providers
- any use of tax refunds by the fund without passing on the full benefit to members

* How trustee companies and funds spend their members' money, identifying significant cost items. These should include:

- remuneration of trustees and senior executives
- any commissions paid
- marketing expenses, particularly for public offer funds seeking to acquire new members outside the default group to build market share
- membership and other payments made to industry associations/advocacy groups (amount, recipient and purpose)
- donations made to organisations, particularly if related to employer/employee sponsors (amount, recipient and purpose)

* The basis on which taxes, e.g. earnings tax and capital gains tax, are allocated to individual member accounts, including the allocation of unrealised capital gains on account closure.

The SMSFA also has said

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

6. IPA report (April 2010)

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

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

The IPA highlighted a surprising fact that

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

The report said

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

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

At the heart of this web is an entity called Industry Super Holdings Pty Ltd (ISH)

which is owned by a clutch of industry funds. In its last set of financial statements (available from ASIC 2009) ISH declared it controlled over \$37.7bn in assets. ISH owns 100% of:

- Industry Funds Management (funds under management \$19.5bn)
- ME Bank (worth \$1.4bn)
- ME Investments (funds under management \$756m)
- IRIS (worth \$643m)
- AusFund (funds under management \$575m) and
- Industry Funds Services (a provider of membership management, financial planning and other services).

Each of these entities provides funds management and other services back to industry funds as 'outsourced' providers. But each of these service providers are owned by a corporate structure (ISH) which is in turn owned by industry funds. This makes for a highly complex and confusing disclosure regime. (page 13)

Twelve people (2009) across the industry funds industry hold directorships or executive positions where they control \$188 billion of financial assets. (page 21)

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

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

7. CalPERS as a model

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

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

On disclosure:

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

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

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

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

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

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

8. Exposure Draft Bill of December 2015

In summary, the Superannuation Legislation Amendment (Transparency Measures) Bill 2015 proposes two measures.

- *Portfolio holdings disclosure (PHD)*
This will require funds to disclose assets held directly, through associated entities and by the first non-associated entities of the RSE licensee, as well as the value of these assets.

Funds will have to provide a table that “will capture direct investments made by the RSE, which will include the investments in financial products of either associated and non-associated entities, and other property.”

“the requirement covers any investments that are made by the RSE, an associate of the RSE or in the first non-associated entity of the RSE. The information required must enable the identification of each investment option, each financial product and other property allocated to each investment option, and the value of the investments.”

Disclosure must occur within 90 days after the reporting requirement dates (which occur twice a year).

Where super funds cascade management of their money to other entities disclosure only would be required on any ‘associated entity.’ This would appear to exclude, for example, subcontracted fund managers. See the discussion below.

- *Choice products dashboard*
Will provide a summary of information for consumers about a fund's MySuper and choice products.
Dashboards are currently required for MySuper products. The new Bill will require a dashboard for funds 10 largest ‘choice’ investment options.

The regulations describe in considerable detail how the PHD and Dashboards need to be set out on funds' websites.

There are qualifications where the fund does not have to comply. For example, disclosure is required only for investments that are entirely controlled by the fund—that is, where the fund has “absolute discretion to vary or replace the financial products or any other property allocated to the investment option.” In other words, where members choose their own asset allocation, this is not included in the dashboard.

The regulations also add disclosure requirements for the reporting of fees and other costs on the dashboard. This measure will only provide an overview of fees and not deal with specifics.

As stated earlier, we do not comment on the dashboard. The area in which we are interested is the ability for forensic analysis to be conducted on all aspects of APRA funds’ management.

9. Issues arising and recommendations about the Bill

9.1 Expenses

** The Bill should be expanded to include requirements to disclose all expenses of APRA-regulated funds. The money does not belong to the funds. The money is compulsorily taken from Australian workers. There can be no excuse or justification for not disclosing all expenses or for not disclosing who receives income/revenue from the funds and how much.

** The standard that should be required is that delivered by CalPERS as evidenced and as exemplified in the attachments 1 to 4 from the CalPERS website showing details of payments for administration, consultants, fund managers and hedge funds.

Anyone who seeks to obtain revenue/income from APRA funds should accept it as a matter of course that, in receiving such income/revenue, their income/revenue will be fully and publicly disclosed. If they object to such disclosure, they have a simple option—namely, not to provide services and not to receive income/revenue from the funds.

9.2 Reporting timelines

The Bill would require funds to disclose 90 days after the two reporting periods required under the Corporations Act. This means that from time of acquisition to the date of reporting can be as long as nine months. We feel that this is too long. As stated earlier, the APRA funds should face higher disclosure requirements than those faced by corporations.

** We submit that APRA funds should be required to report four times a year with disclosure still set at 90 days. This would mean that the maximum period between asset acquisition and disclosure would be six months.

9.3 Associated Entities

We have significant concerns over the non-reporting requirement of non-entities and request reconsideration of this issue.

We can understand that, for example, if an APRA fund purchases shares in a bank, that the disclosure requirements of the fund not be imposed on the bank.

However, from what we understand of the definition of ‘associated entity’ under the Corporations Act, this may enable entities that are actually owned by the superannuation funds to avoid disclosure. Such mechanisms could/would enable large transfers of funds to entities that are fund-owned but which, under the Corporations Act, are not considered ‘associated’, thereby avoiding disclosure requirements.

Again, we argue that because of the compulsory nature of superannuation contributions, the APRA funds are in a special position that requires disclosure of a higher standard than that faced by corporations.

To give a specific example: The IPA report (attached) at pages 13/14 shows the holdings of Industry Super funds in several entities. Some 36 Industry funds own Industry Super Holdings (ISH). ISH, in turns, owns several companies, one being ME Bank. The money that enabled the creation and ownership of ME Bank came from the superannuation deposits of Australian workers. Yet, as we understand it, ME Bank would not be considered an ‘associated entity’ for the purpose of the disclosure requirements. Yet ME Bank is clearly the property of the super funds.

The ME Bank example makes it clear that the idea of ‘associated entity’ for the purpose of APRA regulated superannuation funds needs to be reconsidered. It would seem appropriate that these entities, owned by the superannuation funds, should be subject to the disclosure requirements of the superannuation funds themselves.

9.4 Cost of disclosure

It can be predicted, perhaps, that the superannuation funds will complain that high levels of disclosure imposed upon them will add considerable expense to their administration, diminishing the returns to members. There are several responses to this:

- The funds should already have on hand all the information required for disclosure. The requirements for disclosure on a website (such as CalPERS) should not be a difficult or expensive exercise if the information is already at hand.
- If the funds claim that the information is not readily available, this would immediately raise serious concerns about the competency of the funds’ administration and the reliability of their claimed performance.
- Many of the funds, particularly Industry funds, are big, high-profile spenders on advertising and marketing. That spending is principally directed toward increasing market share and income streams. The highest priority of funds ought to be the assured protections of existing members’ money. If additional funds are needed, money should be diverted from advertising/marketing to disclosure activities.

10. List of attachments

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

Appendix Cooper Report Recommendations Chapter 4

Recommendation 4.1

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

Recommendation 4.2

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

Recommendation 4.3

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

Recommendation 4.4

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

Recommendation 4.5

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

Recommendation 4.6

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

Recommendation 4.7

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

Recommendation 4.8

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

Recommendation 4.9

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

containing:

- (a) gross investment returns, costs and investment returns net of all costs (administration and investment) and taxes for investment options for 1, 5, and 10-year periods; and
- (b) the number of quarters of negative investment returns the investment option has incurred in the past 10 years, or a proxy figure developed using data published by APRA for those options with a history of less than 10 years.

Recommendation 4.10

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

A PRODUCT DASHBOARD (4.11 & 4.12)

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

Recommendation 4.11

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

Recommendation 4.12

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

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

Recommendation 4.13

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

- (a) cost categories and their composition;
- (b) requirement for cost categories to be subject to an annual audit;
- (c) ‘cost categories’ to be reported in the APRA annual return at the whole of fund and MySuper levels; and
- (d) costs to be disclosed to at least the first non-associated entity level.

Recommendation 4.14

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

Recommendation 4.15

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

Recommendation 4.16

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

Recommendation 4.17

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

Recommendation 4.18

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

Recommendation 4.19

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

Recommendation 4.20

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