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Superannuation: accountability, member outcomes and governance

Submission to the Senate Standing Committee on Economics

ABOUT US

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia's largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

To find out more about CHOICE's campaign work visit www.choice.com.au/campaigns

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INTRODUCTION

CHOICE is pleased to see member outcomes placed at the centre of superannuation reform. A number of these reforms are timely and should lead to marked improvements in member outcomes.

For example, giving consumers in workplaces covered by workplace instruments that restrict choice of funds the ability to select their own fund will be a boon for competition. It will also help consumers to better manage their accounts and reduce the need to maintain multiple costly funds if they work more than one job.

Shutting down the salary sacrifice loophole which has seen an estimated \$1 billion stripped from retirement savings by unscrupulous employers is also a great outcome for consumers.

We agree there are sound principles behind the reform to introduce independent directors, however we see the need for refinement. The Bill has the potential to destroy the unique value and culture brought by member directors. Our review of the available evidence suggests that member directors, where appropriately selected, can contribute to good governance, so a role for them should be retained.

Finally, the Bill invests strong powers in the hands of the Australian Prudential Regulation Authority (APRA) with limited guidance on how this power might be exercised. We acknowledge the need for a strong regulator in this crucially important sector. However, it is appropriate that powers of this nature be supported by a regulatory framework that ensures that they are employed as a last resort.

SUPERANNUATION LAWS AMENDMENT (STRENGTHENING TRUSTEE ARRANGEMENTS) BILL 2017

Independent directors

CHOICE agrees this reform is important “because independent directors bring different skills and expertise and they can hold other directors accountable for their conduct, particularly in relation to conflicts of interest.”¹ However, the Bill as currently proposed fails to acknowledge the value added by employee representatives on superannuation boards.

In coming to this conclusion on the value of independent board directors CHOICE has reviewed a wide ranging set of both local and international research. What is clear from this review is that the value of independent directors is difficult to quantify. Given the Australian and international corporate governance guidelines place importance on independent directors, much of the research and regulatory guidance takes for granted independent directors’ value. Instead, the research focuses on what proportion of directors should be independent.

Agency theory underpins the research on independent directors. This theory holds that there is an imperfect goal alignment between executives (agents) and shareholders (principles), where executives have an incentive to act in their own interests to the detriment of shareholders. Under agency theory this problem can be controlled by boards containing directors who are independent from the executives, and are consequently able to hold the board to account and act in the best interests of shareholders.

In contrast, stewardship theory holds that executives are better placed to deliver in the best interests of shareholders because of their experience, knowledge and personal investment in the outcomes of a company. The research to date has found both positive and negative correlations between independent directors and favourable company outcomes.²

¹ Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017 Explanatory Memorandum, p.9

² AICD, 2016, ‘Research series: The relationship between board independence and stock price performance’

The description of ‘executives’ in these two theories does not apply neatly to the superannuation context, where the equal representation rule in the not-for-profit sector allows for employer and member representatives. However, executives and non-independent board members (e.g. member and employer representatives) share some of the same attributes in superannuation. In theory they are both closely linked and personally interested in the outcomes of the superannuation fund.

The Australian Institute of Company Directors (AICD) research series ‘The relationship between board independence and stock price performance’ adds more nuance to these two theories.³ It notes that the published literature examining the relationship between board independence and company performance in Australia is contradictory. The AICD research attempts to explain these contradictions by considering the impact the varying degrees of board independence have on stock returns.

The research has two key findings, firstly, the degree of independence is found to improve returns up to a point, after which higher degrees of independence produce worse outcomes for returns. The point of best share return came from boards with 41-50% independent directors. This indicates some evidence for the minimum one third independent directors’ approach.

Secondly, the research found that ‘balanced’ boards in terms of independent and non-independent representation are likely to outperform all others. This finding indicates that there is also value in non-independent directors.

One very important caveat of this research is that industry knowledge or expertise and independence are not necessarily mutually exclusive. In fact there would need to be further research to examine whether companies with independent directors who also have expertise, industry knowledge or an alignment with member interests would outperform others.

Broadly these findings align with the legislative aim of requiring at least one third independent directors. However, what the legislation lacks is an acknowledgement that non-independent directors play an equally important role in good governance.

³ AICD, 2016, ‘Research series: The relationship between board independence and stock price performance’

The main feature of agency theory is that there is a misalignment between the interests of executives and shareholders. However, in a not-for-profit superannuation context this misalignment is likely to be far less prevalent given the closer alignment between member interests and member representatives on boards. In light of this factor, there is a significant risk that stipulating independent director quotas, without ensuring member directors, may destroy the value created by member representation.

Recommendation: That the Committee consider the role of member directors in producing good member outcomes and additional reforms that would ensure that value is preserved.

TREASURY LAWS AMENDMENT (IMPROVING ACCOUNTABILITY AND MEMBER OUTCOMES IN SUPERANNUATION MEASURES NO. 1) BILL 2017

Annual MySuper outcomes assessment

Improving competition with the goal of improving consumer outcomes is an important measure in the default superannuation market. The Bill requires an RSE licensee to determine and publish on the superannuation fund's website whether the financial interests of the MySuper members are being promoted. We note that the information on which this assessment is to be made is already largely in the public domain, so the main addition of this Bill is a requirement on the RSE licensee to publicly self-assess its performance. While we see no great harm in this regulatory requirement, the value it may add is not clear.

We see the work of the Productivity Commission in proposing new default models for allocation coupled with its analysis of behavioural aspects in product switching as better suited to speeding up the process of the consolidation of inefficient funds. Annual MySuper outcomes assessments may simply add to the plethora of unread information available on funds, without driving better consumer decision making.

Recommendation: That the Committee assess the value to consumers of RSE licensees being required to publish self-assessments.

Regulatory shift in APRA powers

The Bill gives broad powers to APRA over an RSE licensee in relation to virtually every aspect of its business. CHOICE understands the need for a regulator to have a complete toolkit when it comes to its oversight of such an important sector. We would hope APRA would be judicious in its use of these powers. Our expectation would be that the threat of using these powers would, in all but the rarest circumstances, be sufficient to drive compliance.

However, given the significant impact an APRA decision could have on a fund's members we maintain that there needs to be appropriate checks and balances to ensure these powers are exercised appropriately. This may include a regulatory framework which provides clarity for funds on how APRA will exercise its powers. This framework could include a graduated response scheme that commits APRA to where possible work with the RSE licensee in the first instance to resolve an issue before proceeding to issue directions.

Recommendation: That the Committee consider the need for appropriate checks and balances on APRA's exercise of its expanded powers.

Annual members' meeting (AMM)

CHOICE is pleased to see attention given to ways in which members can have more opportunities to engage with their superannuation fund. However, as currently envisioned the purpose of these meetings is unclear. The main purpose appears to be to provide an opportunity for members to ask questions of their fund. However, a similar obligation already exists under the Superannuation Industry (Supervision) Act.⁴ The main difference under the new provision is that questions and answers would be visible to the entire membership through the meeting and its minutes.

Running these meetings is potentially an expensive obligation with limited benefit. CHOICE maintains that in principle an AMM is a positive step towards better member

⁴ section 101 Superannuation Industry (Supervision) Act

engagement, but greater thought could be given to how these meetings could empower members.

We acknowledge that complex processes like director elections could be one way to engage the membership, but would require certain safeguards to ensure directors with the rights skills and experience were elected, and to ensure that members who were not able to attend a meeting person were able to participate. This may be an option worth considering in the future for the appointment of directors with member experience.

A less controversial option for encouraging member engagement would be to allow the membership to vote on non-binding motions. These could be subject to appropriate notice requirements, and could be used to provide an expression of member expectations to funds without necessarily interfering with the duty to the broader membership. For example, there is currently a campaign to divest superannuation investments from the tobacco industry.⁵ An active group of members could combine to put a motion to their fund to disclose any tobacco investments (if not already disclosed) and request that they pull out from these investments. The motion would not be binding on the fund, and the fund could continue to invest in tobacco if it could justify it was in the member's best interests to do so, however it would give members a public platform to apply pressure to the fund and help ensure their retirement savings are invested in sustainable products that align with their values.

Allowing this level of engagement is vitally important to fostering consumer faith in the superannuation system. Superannuation requires consumers to compulsorily 'give up' 9.5% of their income to save for retirement, and while this is an important feature of the system, it leaves many feeling disengaged in relation to how these funds are invested. Members are more likely to feel ownership over their funds if given a mechanism to direct public pressure on how they are invested.

Given the non-binding nature of this mechanism it may seem tokenistic. However, it would be a brave fund that believed it was acting in the best interests of its members if it ignored a motion passed with a significant majority at an AMM.

Recommendation: That the Committee give thought to how AMMs could be used to better engage members.

⁵ <http://www.abc.net.au/news/2017-06-22/meet-the-doctor-hitting-big-tobacco-where-it-hurts-investors/8638328>

TREASURY LAWS AMENDMENT (IMPROVING ACCOUNTABILITY AND MEMBER OUTCOMES IN SUPERANNUATION MEASURES NO. 2) BILL 2017

Choice of fund

The Productivity Commission has pointed to evidence which estimates 20 per cent of members are unable to exercise genuine choice due to restrictions under their workplace instrument.⁶

This is a significant restraint on member-driven competition. CHOICE is regularly contacted by consumers who are frustrated by their inability to select a fund of their choice. Recently we were contacted by a consumer who was forced to maintain an account with UniSuper against her wishes because it was the nominated default fund in the industrial agreement under which she was casually employed with a university. Initially she had taken to consolidating her UniSuper account into QSuper every few months in order to follow the conventional logic that paying two sets of fees was wasteful. However, she was continuing to be charged fees for the first month with UniSuper before she was able to enact a transfer. This was a sizable proportion of her balance given she was employed for limited hours on a casual basis. She had eventually resolved to maintain two accounts but take up a cash investment option with UniSuper to minimise the fees on her small balance.

Her chosen fund was with QSuper, which she had chosen because she preferred the customer service experience. In terms of net returns performance, the default UniSuper and QSuper funds perform comparatively well against the market, so either would have been a sound choice.⁷ However, this consumer had gone to the extra effort of exercising choice based on her customer service experience. Under a properly functioning market

⁶ Productivity Commission, 2017, 'Superannuation: Alternative Default Models', March 2017, p.33

⁷ <https://www.superguide.com.au/boost-your-superannuation/top-10-performing-super-funds-2015-2016-financial-year-past-10-years>

she would have been able to exercise this choice and QSuper would have been rewarded for its superior customer service in the customer's eyes.

Currently the market fails to serve consumers in this situation and leads to perverse outcomes, like the need to invest sums of money in lower performing options in order to avoid fees, as well as disincentivising funds to actively compete on customer service.

Recommendation: That the Committee support the legislative reform which will give consumers the right to select their own superannuation fund where they are employed under a workplace determination or enterprise agreement that is made on or after 1 July 2018.

Salary sacrifice integrity

We are pleased to see the closing of a loophole which allowed employers to steal from employees who salary sacrifice. The existing loophole has been exploited by some employers to use an employee's voluntary contributions to pay the employer's Superannuation Guarantee (SG) requirements. ISA estimates that for the 2013-14 year alone \$1 billion in contributions went unpaid due to this rort.⁸ Left unchecked this could have a devastating impact on the retirement savings of Australians. This is a common sense reform which CHOICE fully supports.

Recommendation: That the salary sacrifice integrity reforms be progressed in full.

⁸ ISA, 2016, 'Overdue: time for action on unpaid super', p.6, available at: <http://www.industrysuperaustralia.com/assets/Reports/Final-Unpaid-Super-January-2017.pdf>