

## The Cooper Review: Special Comments

*Welcome to Shifting Geer, Herbert Geer's superannuation and funds management newsletter.*

*This issue of Shifting Geer addresses the Cooper Review recommendations.*

### 1. INTRODUCTION

On 5 July 2010, the final report of the Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System (**the Cooper Review**) was released publicly. The Cooper Review Panel (**the Panel**) released 177 recommendations covering:

- (a) MySuper and the choice architecture;
- (b) trustee governance;
- (c) investment governance;
- (d) outcomes transparency;
- (e) insurance in superannuation;
- (f) system integrity;
- (g) retirement;
- (h) self-managed superannuation;
- (i) SuperStream; and
- (j) regulatory settings,

for the purposes of benefiting fund members.

This edition of Shifting Geer summarises and addresses all the above recommendations, except for those relating to self-managed superannuation funds (**SMSFs**).

### 2. MYSUPER AND CHOICE ARCHITECTURE

#### 2.1 Adoption of the choice architecture model<sup>1</sup>

The Panel recommends a "choice model" of superannuation based upon the premise of representing member's best interests. Under the choice model members should be allowed to either make conscious decisions when selecting their superannuation options (**Choice Products**) or default into a standard superannuation product (**MySuper**). Under the choice model the subsequent costs allocated to members should occur with greater precision depending on the choices members make as to the forms of funds and investment options they pursue. Dependant on a member's choice, as to what form of fund or investment strategy they wish to pursue, the Panel proposes that the level of regulatory overlay will increase (for members who choose default options) or decrease (for members who establish SMSFs).

Central to the choice model is the creation of MySuper default-products that the Panel recommends can only be the superannuation product that can be nominated as an employer's-default fund. In order for a fund to provide a MySuper product, the trustee would be required to hold a MySuper class of registrable superannuation entity (**RSE**) licence, which would most likely occur by varying an existing RSE licence. MySuper products have the following characteristics:

- (a) a single diversified investment strategy;
- (b) members will have no investment decision-making powers;

<sup>1</sup> Recommendations 1.1-1.3, 1.6, 1.7, 1.18

- (c) the trustee must determine, annually, whether it has sufficient scale (both asset size and member numbers) to deliver optimal benefits to members;
- (d) intra-fund advice;
- (e) they can fit within a fund, however costs accruing to MySuper members must be segregated so there is no risk of MySuper members cross-subsidising other fund members; and
- (f) there should be no entry (contribution) fees and exit fees could only be charged on a cost-recovery basis.

The Panel recommends a two-year period in which the superannuation industry can transition to the new choice architecture.

### **Herbert Geer Comment:**

*Under the proposed choice model, current funds do not have to provide a MySuper option, however if a fund wishes to remain eligible as an employer's default fund under the SG and industrial legislation and, it would have to provide a MySuper option.*

*The recommendation that trustees must determine whether their MySuper products have sufficient scale is the one of the most controversial recommendations as it purports to give APRA de facto power to push for the consolidation of funds. See our further comments in paragraph 10.2 below.*

*In order to provide for intra-fund advice, trustees will need to vary their AFSL (or obtain one) to contain a personal advice authorisation. This could be difficult for some current providers as they might not have the personnel with the appropriate skills and experience and they will have to buy this in or utilise another Licensee's arrangements.*

*If MySuper members are effectively segregated so there is no risk of MySuper members cross-subsidising other fund members, it is likely that trustees will either have to increase Choice Product fees or reduce the number of Choice Product options available to fund members. If Choice Product fees rise (due to the inability to cross-subsidise), many members may be dissuaded from placing their assets in lower risk investment options (such as a cash option) or to diversify by selecting multiple Choice Product options. In the event of market downturns, higher Choice Product fees may dissuade members from attempting to preserve their superannuation assets if the costs of investing*

*in a low risk investment option outweighs that option's lower (but safer likelihood of) returns. The inability to cross-subsidise may reduce funds' economies of scope that are advantageous to both funds and their members.*

*On a more practical note, trustees and their associates may need to consider how they are to be reimbursed for services rendered to members. Potentially fees and costs will be pro-rated between MySuper members and Choice Product members, however, it may be difficult to precisely value these costs when taking into account the fact that the level of work respectively involved in administering MySuper and Choice Products may vary, depending on the circumstances.*

## 2.2 Retirement Savings Accounts and Approved Deposit Funds<sup>2</sup>

The Panel recommends the transfer of existing retirement savings accounts and approved deposit funds to MySuper or other superannuation products.

## 2.3 Disclosure<sup>3</sup>

The Panel considers that MySuper products would have reduced disclosure obligations because entry into MySuper is not based on the notion of informed choice. The reduced disclosure obligations would translate into member cost reductions. Member benefit statements would continue to be sent out as currently required.

### **Herbert Geer Comment:**

*Whilst MySuper products may require less disclosure for default members, it is likely that members who have already invested in, are considering investing in, or considering opting-out of Choice Products would require MySuper products to have the same degree of disclosure as Choice Products, in the event those members wish to make informed comparisons. If there is disparity between the disclosure of MySuper products and Choice Products, trustees may expose themselves to the risk of claims of misleading or deceptive behaviour.*

*The risk with not having a PDS or like document for MySuper trustees is the risk that when a member makes a claim (for example, TPD) there may be uncertainty as to what the terms of the policy were at the date of membership or date of claim. The*

<sup>2</sup> Recommendations 10.12 & 10.13

<sup>3</sup> Recommendation 1.7

*Fund's website would have to have the ability to track which terms were applicable at multiple dates.*

*As for joining a MySuper fund online, we suggest that if members don't fill in application forms now, why would they bother doing so in this format especially if it is a default fund.*

## 2.4 Advice<sup>4</sup>

The Panel recommends a system in which MySuper members should be allowed to opt-in to receive (non-intra-fund) advice, on the basis that such advice is commonly bundled as a cost paid collectively by all fund members, irrespective of whether they individually requested or received fund advice. Under this regime, any arrangement to provide superannuation advice to a member could only operate for a period of no longer than 12 months, after which time it would elapse if not expressly renewed. Anti-avoidance rules would be necessary to prevent arrangements designed to have members committing to payments over a longer period.

Further, the costs of any advice provided to employers should not be borne by MySuper members and trustees should neither pay nor fund any product-based up-front or trailing commissions or other similar payments in respect of superannuation advice or other products or services provided to members.

### Herbert Geer Comment:

*This recommendation may prove costly either to any member who receives advice or to funds who have to subsidise the costs of advice to a limited number of members who opt-in.*

## 2.5 Switching advice<sup>5</sup>

The Panel recommends that switching advice rules, similar to those that apply under the statement of advice rules under the Corporations Act 2001 (**the Corporations Act**), should also apply to fund trustees who recommend a MySuper member move their investment into a fund's alternative Choice Product investment option.

## 2.6 Mandatory retirement forecasting<sup>6</sup>

The Panel recommends that MySuper products should provide members with standardised

retirement projections in order to raise members' awareness of their likely financial position at retirement and to prompt them to reconsider their superannuation investment strategies (if required). The Panel proposes that retirement forecasting would:

- (a) be provided in relation to a member's account balance and a set uniform retirement date;
- (b) not consider any entitlement to the age pension or any other superannuation account;
- (c) assume no change to current salary for superannuation guarantee (**SG**) contributions outside set assumptions for inflation, and assume no change to current personal contribution levels;
- (d) assume current taxation and other legal conditions remain unchanged;
- (e) utilise a single set of annual assumptions for investment earnings, insurance premiums, fees and costs across all MySuper funds, developed by government in consultation with the industry and the actuarial profession;
- (f) be accompanied by suitable standard warnings and disclosures including, for example, how the age pension and other assets also determine final retirement income; and
- (g) present the projection as an amount in current-day dollars.

### Herbert Geer Comment:

*ASIC supports the use of superannuation forecasts, releasing Consultation Paper 122: "Superannuation forecasts: ASIC relief and guidance for super funds" and a draft regulatory guide in October 2009. The industry response to that consultation paper highlights the risk of discrepancy between members' forecasts and actual end benefits unless ASIC considers the following issues:*

- (a) *the adequacy of warnings to state that forecasts are neither an adequate tool for comparing fund performance nor a promise of a member's account performance;*
- (b) *the inclusion (or lack, thereof) of taxation and uniform or individual insurance premiums in order to estimate a member's end benefit;*

<sup>4</sup> Recommendations 1.8-1.12, 1.21

<sup>5</sup> Recommendation 1.15

<sup>6</sup> Recommendation 1.17

- (c) *the ability to forecast on behalf of casual or seasonally employed members whose income may not necessarily reflect their "current" salary;*
- (d) *the use of uniform or individual fees and costs data;*
- (e) *the ability to predict a member's current salary, where contributions may comprise a mix of superannuation guarantee, salary sacrifice, and other contributions;*
- (f) *the use of uniform or individual rates of investment return;*
- (g) *the requirement for actuarial sign-off or other compliance-related activities before certain forecasts can be disclosed; and*
- (h) *the merit in providing forecasts to members approaching retirement phase.*

## 2.7 Choice Products<sup>7</sup>

Choice Products are essentially the non-default investment option components to current superannuation funds. Whilst the Panel focuses more on MySuper throughout the Cooper Review, it does provide some recommendations with respect to Choice Products:

- (a) there should be no entry fees and exit fees should only be charged on a cost-recovery basis;
- (b) neither (non-intra-fund) advice to members, nor employers should be bundled with Choice Products or with any other product in the choice architecture model;
- (c) advice to members (other than intra-fund advice) should only be provided on request (via renewal notices) and trustees should only be able to deduct the costs of advice about superannuation from a member's account with the members' written agreement;
- (d) the costs of any advice provided to employers should not be borne by members, and trustees should not pay or fund any product-based up-front or trailing commissions or other similar payments in respect of superannuation advice or other products or services provided to members; and

- (e) trustees must offer a range of investment options sufficient to allow members to obtain a diversified asset mix if they choose. Trustees would be subject to new express duties in selecting and monitoring options.

## 3. TRUSTEE GOVERNANCE

### 3.1 A new office of "trustee-director"<sup>8</sup>

The Panel states that there is confusion as to how the Superannuation Industry (Supervision) Act 1993 (SIS) covenants apply to trustee boards and their directors. Accordingly the Panel recommends that SIS should be amended to create a distinct new office of "trustee-director" prescribing a trustee-director's duties. Further, the Panel has in mind a code of governance similar to the code developed by the Australian Stock Exchange (ASX) Corporate Governance Council.

#### **Herbert Geer Comment:**

*We are in favour of accountable trustee governance subject to appropriate limits.*

*Section 52(8) of SIS already states that the SIS covenants apply equally to trustee-directors as they do to trustee boards. Our particular view is that the combination of duties prescribed by SIS, Corporations Act and general trust law are sufficient to regulate the behaviour of directors of trustee boards. Cases involving the prosecution of directors of super fund trustees have not seemed to collapse due to any uncertainty about the duties owed by these directors to their members.*

### 3.2 Trustee skill sets<sup>9</sup>

The Panel believes that trustee-directors will require skill sets more akin to those required by the directors of listed company boards of a similar scale and scope. Accordingly, the Panel recommends that a code of governance should incorporate an annual review of trustee board performance in which the board's collective level of fitness could be assessed.

#### **Herbert Geer Comment:**

*Where SIS may be lacking in enunciating to what degree a fund's board of directors must be "fit and*

<sup>7</sup> Recommendations 1.20-1.28

<sup>8</sup> Recommendation 2.1

<sup>9</sup> Recommendations 2.2, 2.3

*proper*<sup>10</sup>, chapter 2D of the Corporations Act essentially requires that directors are “fit and proper” to a standard expected of reasonable persons acting in similar capacities under similar circumstances<sup>11</sup>. Therefore it is arguable that the standards that apply to ASX-listed company directors already apply equally to fund trustee-directors.

### 3.3 Changes to the equal representation rules<sup>12</sup>

The Panel considers that changes to the superannuation industry and certain implementation practices mean that equal representation:

- (a) no longer adequately represents employers or members; and
- (b) can result in inefficient trustee board sizes whilst policy committees can create unnecessary administrative burdens to trustee boards.

The Panel recommends that “non-associated” trustee directors (directors who generally have no historic connection with the fund or the appointor) should be appointed to boards so that non-equal representative boards are comprised of a majority of non-associated directors or current equal representative boards comprise at least one-third non-associated directors.

#### **Herbert Geer Comment:**

*Any rule made subsequent to this recommendation would need to carefully clarify when a person is considered to be a “non-associate” of the trustee or appointor. Trustees will need to amend their company constitutions to reflect this requirement.*

### 3.4 Amendment of section 101 of SIS<sup>13</sup>

The Panel recommends that trustees should provide members with reasons for their decisions in relation to a member’s formal complaint, on the basis that, unlike other forms of trust, superannuation membership and the subsequent contribution of salary and wages is compulsory.

<sup>10</sup> Noting that APRA has been delegated the responsibility of guiding trustees on the fit and proper standard.

<sup>11</sup> See, for example, the Corporations Act, section 180 and Australian Securities and Investments Commission v Rich [2009] NSWSC 1229

<sup>12</sup> Recommendations 2.4-2.7

<sup>13</sup> Recommendation 2.9

#### **Herbert Geer Comment:**

*Under this recommendation, superannuation fund trustees would lose their common law protection against the need to defend claims, against decisions that were properly made<sup>14</sup>. Such a recommendation could prove costly to funds (and hence their members) on the basis that funds would be exposed to increased litigation once the trustee is required to disclose its reasons for acting in a certain manner (even if the trustee’s discretion was within its powers and properly considered).*

### 3.5 Indemnification of trustee-directors<sup>15</sup>

The Panel recommends that the liability provisions under section 197 of the Corporations Act should not apply to superannuation fund trustees and directors on the basis that it conflicts with sections 56 and 57 of SIS which provides indemnities to trustee-directors.

The Panel also recommends that all trustees should be required to hold appropriate indemnity insurance and that it should be an RSE licence condition to provide a certificate of currency annually to the Australian Prudential Regulation Authority (APRA) in order to tackle the risk of a successful claim against a trustee not being paid because the trustee lacks indemnity insurance or is not capitalised.

#### **Herbert Geer Comment:**

*Section 197 of the Corporations Act unambiguously states that personal liability is imposed on a trustee-director only where the corporation’s right of indemnity as trustee is lost through one or more of the following three circumstances:*

- (a) a breach of trust;
- (b) an act outside the corporation’s scope of its powers as trustee; or
- (c) because of a term of trust denying or limiting the corporation’s right to be indemnified.

*Further, the above liability only attaches to those directors acting in breach of their powers.*

*On the other hand, SIS requires trustees to be indemnified, except where there is a breach of trust. SIS also allows (but does not require) a fund’s governing rules to indemnify trustee-directors except for cases where a liability arises because a*

<sup>14</sup> Karger v Paul [1984] VR 161

<sup>15</sup> Recommendations 2.10, 2.11

*director fails to act honestly, or intentionally or recklessly fails to exercise the requisite degree of care and diligence.*

*These laws are essentially consistent with each other and with the common law and state-based trustee law<sup>16</sup> that entitles trustees to be indemnified out of trust assets to the extent that no breach of trust occurs.*

### 3.6 Multiple board appointments<sup>17</sup>

The Panel recommends that directors be allowed to be appointed to more than one fund trustee board provided that both boards attest that at the time of appointment there is no reasonably foreseeable conflict between the director's duties to the members of each fund and to each trustee company.

### 3.7 Gifts, emoluments and other benefits<sup>18</sup>

The Panel recommends that a record of all gifts, emoluments and benefits (subject to an appropriate materiality threshold) provided to trustees, trustee directors and management should be kept in a register maintained by the trustee and disclosed to APRA annually, as well as in the annual fund report to members and on the fund's website.

### 3.8 Code of governance<sup>19</sup>

The Panel recommends that a code of trustee governance is developed and includes a principle to ensure that gender equality is pursued with reasonable haste. Whilst the code would not necessarily mandate a specific quota, the Panel notes that boards holding at least 40% female directors would be in keeping with emerging international best practice.

The Panel recommends an annual audit of each trustee's performance against the code and the results of such audits should be made available on each fund's website.

The code should cover as a minimum:

- (a) imposing a higher standard of competence and commitment of time on the chair;

- (b) board size and any transition period for successor fund transfers and mergers;
- (c) length of directors' tenure and retirement by rotation;
- (d) development of an enhanced conflicts handling policy;
- (e) skill sets for each director to demonstrate within the first 12 months of appointment;
- (f) a skill matrix for the trustee board and analysis of how a board's current composition provides the skills required under the matrix;
- (g) procedures for a rigorous and independent annual review of a board's collective competence and each trustee-director's performance;
- (h) gender and other diversity requirements;
- (i) tendering for and benchmarking service providers; and
- (j) minimum ongoing training requirements.

#### **Herbert Geer Comment:**

*The Association of Superannuation Funds of Australia has previously released Best Practice Papers outlining elements of good fund governance, based upon the ASX Corporate Governance Council's "Principles of Good Corporate Governance and Best Practice Recommendations". Corporate governance would be considered to be in fund members' best interests, because governance goes to the core of fund administration and subsequent returns of member's investments. APRA's Fit and Proper Person Standards also cover a multitude of the abovementioned requirements.*

## **4. INVESTMENT GOVERNANCE**

### 4.1 Investment strategies<sup>20</sup>

The Panel recommends that the SIS investment strategy covenant under section 52(2)(f) should be amended so that, when formulating an investment strategy, trustees additionally consider:

- (a) the strategy's costs, including the methods in which investment managers charge fees;

<sup>16</sup> For example, see the *Trustee Act 1958* (Vic), section 36 & *Trustee Act 1925* (NSW), section 59

<sup>17</sup> Recommendation 2.13

<sup>18</sup> Recommendation 2.15

<sup>19</sup> Recommendations 2.18-2.20

<sup>20</sup> Recommendations 3.1, 3.4, 3.5

- (b) the strategy's taxation consequences on members on the basis that the value of returns may be eroded due to the taxation of those returns; and
- (c) the availability of valuation information that is both timely and independent of the fund manager, product provider or security issuer.
- (e) the assessment of performance fees to particular asset-class benchmark standards, rather than simple measures such as absolute market growth;
- (f) prohibitions on the resetting of performance fee bases or eligibility;

The Panel considers that investment strategies may inadvertently reduce the value of members' returns when fees, costs and the effect of taxation are factored in. The Panel notes, however, that it is beyond its reach to define precisely what processes trustees ought to have in place to have due regard to a strategy's tax consequences.

The Panel notes that non-market listed investments pose valuation problems when trying to determine the value of a fund's assets often because the methodologies required to value these assets are highly technical. Therefore the Panel recommends that trustees must satisfy themselves that there is a valuation process that includes regular, timely input, independent of the underlying product or service provider or security issuer. The Panel considers that the failure to have such a process would be regarded as imprudent.

#### 4.2 An enforceable performance fee standard<sup>21</sup>

The Panel recommends that performance-based fees should be the exception rather than the rule because trustees should have the buying power to demand fully focused, motivated and incentivised managers by reason of the price they contract to pay for those manager's services. The Panel believes that APRA should develop a standard dealing with performance-based fees addressing:

- (a) the application and setting of high water marks where a period of negative returns eroding a future performance fee's base requires the performance fee base to be reset;
- (b) claw-backs of investment manager performance fees;
- (c) whether performance measurement should be based on a post-tax basis;
- (d) the relationship between base fees and performance fee arrangements;

- (g) the management and disclosure of unit pricing;
- (h) a longer testing period in order to assess investment performance;
- (i) the capping of fees;
- (j) the effect of performance fee arrangements on the entire portfolio; and
- (k) disclosure of performance fees to members.

Trustees of MySuper products cannot pay performance-based fees unless the payment conforms with the performance fee standard.

#### **Herbert Geer Comment:**

*In our experience we see this working with small Australian fund managers. The practical reality is different in dealing with large overseas fund managers who, in our opinion, will not accept prescribed performance fees as each manager has a different formula or arrangement and Australian funds at this stage do not have the buying power to upset those arrangements*

*Further this recommendation appears to disincentivise fund managers from outperforming the benchmarks set and could lead to either higher base fees or lower returns in the long run.*

#### 4.3 Publication of voting behaviour<sup>22</sup>

The Panel recommends that funds should publish their proxy voting policies and procedures, and disclose their voting behaviour to members on their websites.

#### **Herbert Geer Comment:**

*In our view another inappropriate recommendation noting that most members would not even be concerned with this aspect of operations. Trustees should note that if all MySuper recommendations are adopted that they will spend significant time, effort and huge expense in modifying their websites*

<sup>21</sup> Recommendations 3.2, 3.3

<sup>22</sup> Recommendation 3.6

*and keeping them compliant with all of these requirements. Annual legal and compliance expenses will significantly increase in this regard.*

## 5. OUTCOMES TRANSPARENCY

### 5.1 Outcomes Reporting Standard<sup>23</sup>

The Panel recommends the development of an outcomes reporting standard that would require trustees to calculate and disclose items such as fees, costs and performance at MySuper and Choice Products investment option level according to a standardised methodology in order to improve the comparability and usability of information that is being directed at members. These standards would operate as an overlay to the Australian Accounting Standard 25 (*Financial Reporting by Superannuation Plans*) and Exposure Draft 179 (*Superannuation Plans and Approved Deposit Funds*).

Such a standard will likely address inconsistencies in fund reporting that the Panel has identified due to:

- (a) costs being reported either before or after tax (the Panel recommends that disclosure should be on a gross basis);
- (b) investment returns being reported either before or after tax (the Panel recommends that disclosure should demonstrate investment returns net of tax);
- (c) failure to disclose performance fees paid to investment managers;
- (d) failure to disclose fees paid to underlying investment managers of fund products;
- (e) failure to disclose member protection costs, particularly in years of low or negative returns;
- (f) failure to deduct all costs from investment returns; and
- (g) failure to disclose insurance commissions.

The Panel recommends that trustees should mandatorily disclose a standardised risk measure of the uncertainty or volatility associated with investment returns when quoting past Choice Product investment option or MySuper product performance. The Panel believes this measure requires development in consultation with industry

<sup>23</sup> Recommendations 4.1-4.10, 4.13-4.15

however it considers that the measure could be based over a 10 year/40 quarter-period. In the event that a Choice Product investment option has a shorter history, the Panel recommends that the option's actual history could be supplemented with a measure calculated by APRA to publish a fair indication of volatility over a similar period.

MySuper and Choice Product Trustees would be required to maintain an investment option performance table, easily accessible on the fund's website. This performance table would likely demonstrate gross investment return over a 5 and 10 year period, before peeling away the layers of costs and taxes to provide an overall net investment return.

The Panel further recommends that APRA discloses MySuper investment return performance data. In order to aid APRA's disclosure, trustees would be required to:

- (a) prepare APRA-standard costs reports;
- (b) participate in APRA-approved benchmarking surveys to measure relative efficiency against their peers; and
- (c) allow APRA to collect fund data on a "look-through" basis whereby trustees would report the assets underlying their collective investments to at least the "first non-associated entry level" in order to help analysts calculate rates of return that have been adjusted for the risk of the underlying asset allocation.

### 5.2 Product dashboard<sup>24</sup>

The Panel recommends that all trustees provide a "product dashboard" highlighting:

- (a) net investment return targets, which should be expressed as a percentage above the consumer price index, over a rolling 10 year period;
- (b) a range of possible outcomes for a MySuper product or Choice Product investment option (i.e. a risk target) over a 10 year period in a visual, diagrammatic format;
- (c) the projected liquidity of the MySuper product or Choice Product investment option;

<sup>24</sup> Recommendations 4.11, 4.12

- (d) the 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.

The product dashboard would not substitute for a fuller description of the investment strategy or option and therefore would not replace the product disclosure statement (PDS) or the equivalent on-line disclosure material developed for MySuper products.

The dashboard would disclose whether the investment option's projected liquidity was outside the normal 30 day portability rules by classifying the option according to the degree of liquidity (as high, medium or low).

Due to the ambiguity and the rules surrounding management expense ratios and indirect cost ratios, the Panel recommends that trustees publish a new ratio for each MySuper product or Choice Product investment option being the TAER which would be expressed as:

$$\text{total operating expense} \div \text{average net assets}$$

The TAER is an expense measure assessing trustees' abilities in managing expenses within MySuper products or Choice Product investment options derived from an outcomes reporting standard. The TAER would capture the total operating costs of the MySuper product or Choice Product investment option to at least the first non-associated entity level. The TAER would provide members and other stakeholders a fairly reliable tool for making comparisons between MySuper products and investment options in the area of expense management, including via the product dashboard.

**Herbert Geer Comment:**

*The Panel provides an example of a product dashboard that relies on the use of highly technical box-plot graphical representations to demonstrate the range of possible risk outcomes a member would be exposed to if he or she invested \$100 in a certain investment option. Box-plots are (relatively) complicated statistical representations of the (in this case) 10th and 90th percentile and a median range of the likely return on investment, subject to risk. In order to understand what a box-plot actually represents, the dashboard would require significant instruction for the everyday person to understand.*

*It is notable that Part 1 of the Cooper Review states that the majority of surveyed Australians had low-level numeracy, literacy and problem-solving skills whilst also noting that the current disclosure regime is complicated and difficult for people to understand. However, in relying on box-plots to disclose risk, the Panel seems to be further complicating member disclosure, despite attempting to alleviate uncertainty for members and prospective members.*

*Putting the complexity of calculating a fund's TAER to one side, if the TAER is designed to help members compare funds then there is a risk that the TAER comparison may result in funds competing on a costs- rather than results-focussed basis to encourage membership. The TAER could expose trustees to potential conflicts of interest when determining what is best for a fund's members - more members to encourage economies of scale, or better returns on investment.*

**5.3 Systemic transparency and web-based disclosure<sup>25</sup>**

The Panel recommends a move towards web-based systemic transparency where the disclosure of information would be available to the superannuation industry at large including regulators, academics, analysts, advisers and informed investors. The Panel considers that there needs to be a low cost, but dramatic change in this area. Given that superannuation is a heavily taxed subsidised public good, trustees of superannuation funds must get used to being more transparent about their funds. The Panel recommends strong sanctions for those who fail to comply with such requirements.

The Panel recommends that trustees of MySuper and Choice Products retain and make available and easily accessible on their fund websites:

- (a) systemic information about their respective funds over the preceding 10 year period, or since inception if the fund is less than 10 years old;
- (b) basic fund structural information including but not limited to the fund's governing rules, the most recent audited accounts, the auditor's report in relation to those accounts, the fund's most recent actuarial report and any written advice provided by the actuary, and the fund's most recent 6 monthly statement of portfolio

<sup>25</sup> Recommendations 2.17, 4.16-4.19, 5.11

- holdings disclosed to APRA (to be published 3 months after disclosure to APRA);
- (c) all disclosure documents, including but not limited to the most recent PDS and an archive of PDSs over the past 10 years including supplementary PDSs, the most recent annual fund report to members, the most recent trustee's financial services guide (if applicable), and each significant event or material change notification;
- (d) details of the parties who performed the functions of:
- (i) fund administration;
  - (ii) external audit;
  - (iii) internal audit (if applicable);
  - (iv) fund actuarial services (if applicable);
  - (v) investment management investment related consulting;
  - (vi) asset custody;
  - (vii) insurance; and
  - (viii) legal and tax advice (if engaged on a retainer);
- (e) the names of the corporate trustee and each person involved in the fund's trusteeship;
- (f) each director's role, experience and background, status as an employer or employee representative director or additional independent director and service on any trustee sub-committee; and
- (g) the fund's procedures for the appointment and removal of the trustee and each director of a corporate trustee;
- (h) the trustee's executive remuneration policy and the remuneration details similar to those required for major listed entities;
- (i) related parties and the trustee's policy in relation to transacting with or investing in related parties;
- (j) information with respect to governance information, including the fund's conflicts policy (addressing conflicts as required under the Corporations Act and also conflicts relevant to trustee's SIS duties), voting information, policies and procedures, and insurance information, covering terms and conditions and premium tables;
- (k) the TAER; and
- (l) the terms and conditions applicable to each type of insurance offered by the Fund, along with other information relevant to members including:
- (i) a plain English explanation of the policy terms;
  - (ii) premium tables showing the gross premium charged for each category of member (if relevant) and each \$1,000 of cover at current age with a standard frequency of payment along with any additional costs; and
  - (iii) total and permanent disability (TPD) claim success rates on a basis to be determined after consultation with the industry.
- Finally, all fund websites would be required to provide a link to a government website that would detail the relevant legislative, taxation and other superannuation-relevant information. It is envisaged that such a website would reduce the need for fund disclosure documents to map out general superannuation information (for example disclosure as to the relevant contributions tax rates) on the basis that this information becomes incorporated by reference. Fund disclosure documents will then be able to focus more on the specific product features that each fund provides.

**Herbert Geer Comment:**

*Retrospective and current web-based disclosure may further complicate fund websites which are often already inundated with a variety of brochures and forms aimed at current and prospective members and employers. Further, it may be necessary to manage multiple documents that, when compiled together, form one document (for example a PDS and supplemental information to that PDS). Therefore, web-based disclosure may decrease the ease of accessibility in which members can seek fund information. More fund resources may have to be dedicated to equipping call centre staff with the appropriate skills to field member and prospective member enquiries about what are the appropriate disclosure documents they*

*need to source and to explain what exactly is the TAER.*

*In order for funds to comply with the Panel's recommendations for current and retrospective web-based disclosure, the government website would also be required to ensure that it also holds all relevant information for a period of at least 10 years.*

## 6. INSURANCE IN SUPERANNUATION

### 6.1 Insurance cover under MySuper<sup>26</sup>

The Panel recommends that life and TPD insurance cover must be offered on an opt-out basis in MySuper Products and on an opt-in or opt-out basis or not at all in the Choice Products sector. Income protection may be offered on an opt-out or opt-in basis, or not at all by trustees of MySuper or Choice Product funds. Further, MySuper trustees should proactively offer intra-fund advice to members in relation to their insurance.

### 6.2 Insurance strategy<sup>27</sup>

The Panel recommends that SIS should be amended to require all trustees to devise and implement an insurance strategy specifying the types of insurance to be offered and the default and permissible maximum levels of cover to be offered in a similar vein to the required investment strategy covenant under SIS section 52(2)(f). Further, no other type of insurance (for example trauma insurance) should be permitted to be paid for by members through their superannuation and any existing policies outside those categories should be phased out.

A fund's deed should define TPD in the same manner as the actual insurance policy.

The Panel further recommends that upfront and trailing commissions and similar payments should be prohibited in respect of any insurance offered to any superannuation entity, regardless of rules on commissions that might apply outside superannuation.

### 6.3 Superannuation Complaints Tribunal claims<sup>28</sup>

The Panel recommends that current limitations period with respect to the Superannuation Complaints Tribunal hearing TPD claims should

effectively be extended to six years from the time a member ceases employment.

### 6.4 Death benefits<sup>29</sup>

The Panel recommends that binding death benefit nominations should last for a period of five years and could be invalidated due to certain intervening circumstances in respect of a member.

#### Herbert Geer Comment:

*These recommendations are unlikely to add any further burdens to trustees. APRA already states that trustees should decide in advance how to distribute death benefits if the circumstances of a nominated beneficiary have changed (for example if a member divorces his or her spouse). APRA further states that it would expect to be able to verify that the nomination process is robust and is implemented accordingly and that trustees should disclose to members the procedure they follow in the event there are changes to the dependency status of nominated beneficiaries at the time of the member's death.*

### 6.5 Self-insurance<sup>30</sup>

After a suitable transition period, self insurance of any fund benefits, including death and TPD benefits, should not be permitted in any large APRA fund except defined benefit funds (or sub-plans) that are currently allowed to self insure.

## 7. INTEGRITY OF THE SYSTEM

### 7.1 Capital adequacy<sup>31</sup>

In response to the concern that the 1993 capital adequacy provisions (that trustees or a guarantor hold \$5,000,000 in net tangible assets) do not adequately cover risk, the Panel recommends new capital requirements for trustees on a risk-weighted basis being that:

- (a) trustees can maintain a dedicated and identifiable operational risk reserve separate from member account balances;
- (b) all large APRA funds must hold a minimum level of operational risk reserve, expressed as a percentage of fund assets, which cannot be fully offset by trustee capital;

<sup>26</sup> Recommendations 5.1, 5.6, 5.9, 5.13

<sup>27</sup> Recommendations 1.14, 5.3, 5.4, 5.8, 5.12

<sup>28</sup> Recommendation 5.7

<sup>29</sup> Recommendations 5.14, 5.15

<sup>30</sup> Recommendation 5.16

<sup>31</sup> Recommendation 6.1

- (c) APRA should have the power to increase the minimum level of capital on a risk-assessed basis;
  - (d) any capital requirement that would otherwise be imposed under the trustee's Australian Financial Services Licence in respect of non-superannuation business should be in addition to the capital requirement imposed under SIS;
  - (e) trustees of small APRA funds (**SAFs**) should be required to hold an amount of net tangible assets in their own right, calculated by APRA, that would be required if the aggregate of SAFs under trusteeship were a single fund; and
  - (f) the capital adequacy requirements for prudentially supervised conglomerate groups should have regard to the operational risk reserves in any superannuation fund or funds that are in the group and adequacy requirements for group trustees should have regard to the risk weighted assets of the rest of the conglomerate group.
- conditions. Licence conditions should include a risk-weighted capital requirement;
- (b) require that trustees may only use a superannuation administrator licensed by APRA for administration functions which are covered by the outsourcing of the rating standard;
  - (c) require commercial clearing houses to be licensed as administrators; and
  - (d) make clear that the trustee remains liable to the member in the first instance even if the trustee has outsourced administration to a licence administrator.

### 7.3 Risk management<sup>33</sup>

The Panel recommends that SIS should be amended so that

- (a) the trustee is not required to make a copy of the its risk management plan (**RMP**) available to a member or to the employer-sponsor in the case of the defined benefit scheme; and
- (b) A trustee is not obliged to prepare a separate RMP in relation to the nominated RSEs, if it makes a formal decision that the risk management statement (**RMS**) fully addresses all risks relevant to one or more of the RSEs under its trusteeship and documents that fact within its RMS.

Further, the RMP should explicitly include a liquidity management component to ensure that trustees identify and manage liquidity risk at both the fund level and the investment option level with particular regard to the effect of liquidity on investment options offered to members in the retirement phase.

### 7.4 Defined Benefit Funds<sup>34</sup>

The Panel recommends that defined benefit funds should automatically qualify as default funds under the choice model. However, if the defined benefit fund is a hybrid fund, then the MySuper criteria must be met for accumulation members in order for the fund to be accepted as a default fund under the *Superannuation Guarantee (Administration) Act 1992* in respect of those members.

The Panel recommends that APRA issues a prudential standard focussing on funding to protect

### Herbert Geer Comment:

*Currently public offer industry fund trustees must hold an administration reserve of \$100,000, as a condition of their RSE licences. The Panel fails to indicate what size an operational risk reserve should be, however it believes that such reserves should be calculated having regard to the risks faced by each fund trustee. It is likely that the operation of an operational risk reserve could be an expense borne by trustees, which may in turn raise costs to members, and the Panel provides no indication of how the reserve, or the investments to fund the reserve are to be held, or whether there will be any restrictions on how the reserve is to be held or invested and if investment returns will be affected.*

### 7.2 Administrators<sup>32</sup>

The Panel recommends that SIS should be amended to:

- (a) define the term "superannuation administrator" and empower APRA to licence superannuation administrators, modelled on RSE licensees, and to enable APRA to impose, modify or revoke additional

<sup>32</sup> Recommendation 6.2

<sup>33</sup> Recommendations 6.3-6.9

<sup>34</sup> Recommendations 6.10-6.15

“vested benefits”, rather than the “minimum requisite benefit”. The standard must specify a time period within which a defined benefit fund that is in an unsatisfactory financial position must be restored to a satisfactory financial position, in much the same way that SIS presently addresses insolvency of funds and minimum requisite benefits. Insolvent defined benefit funds should not be allowed to accept SG contributions unless the fund actuary and trustee form the view that it is reasonable to believe that the fund will be restored to solvency within the SIS-prescribed period.

## 7.5 Control over investments<sup>35</sup>

The Panel recommends that trustees should not be fettered by government mandate as to what asset types or classes they invest in. In developing investment strategies, trustees should explicitly consider both short and long term risks, consistent with their stated investment horizon.

## 8. RETIREMENT

### 8.1 MySuper retirement income streams<sup>36</sup>

The Panel recommends that MySuper products must include one type of income stream product, either through the fund or in conjunction with another provider, so that members can remain in the fund. The effect of this recommendation is that with the decrease in complexity, the costs in administering one type of income stream should lead to reduced costs to retirees.

Additionally, the Panel recommends that MySuper trustees devise a separate investment strategy for post-retirement members which has regard to those factors set out in the SIS investment strategy covenant, as well as inflation and longevity risk, on the basis that investment risk during the post-retirement phase is heightened by reduced investment horizons (in comparison to the accumulation phase) and there is limited ability to offset poor returns with higher contributions or other income.

Finally, the Panel recommends that trustees should proactively offer intra-fund advice to MySuper members as they approach normal retirement age on a variety of financial issues that members will face in retirement. Once members enter retirement phase, trustees should provide intra-fund advice at periodic intervals.

<sup>35</sup> Recommendations 6.17, 6.18

<sup>36</sup> Recommendations 7.1-7.4

## 9. SUPERSTREAM

### 9.1 Use of tax file number information to streamline superannuation<sup>37</sup>

The Panel proposes members' tax file numbers (TFNs) as the primary form of member identification on the basis that the TFNs do not change (as opposed to other forms of member identification such as addresses and may be less susceptible to typographical error. Mobile phone numbers have been considered as another means of permanent member identification on the basis that these numbers rarely change.

The Panel proposes that reliance on TFNs will make it easier to:

- (a) link a member's contributions and rollovers with his or her account;
- (b) ensure that the Australian Taxation Office (ATO) has a member's correct details;
- (c) ensure accurate identification of a member; and
- (d) reconcile lost entitlements or consolidate multiple accounts into the member's current superannuation account.

The Panel recommends the enactment of legislation to permit trustees to auto-consolidate accounts without prior reference to the member, where multiple accumulation accounts within a single fund share a common TFN and member surname, and the multiple accounts have not been established by deliberate elections by the member concerned.

### 9.2 Use of technology and e-commerce<sup>38</sup>

The Panel advocates for greater use of e-commerce and refers to straight-through processing (STP) which is an initiative used by companies, globally, to complete end-to-end transactions (both data and monetary) without any form of manual handling or intervention (in other words, completely electronically). Among the forms of STP the Panel highlighted is standard business reporting (SBR) which is designed to enable Australian entities that are required to provide various regulators (for example APRA, the Australian Securities and Investments Commission, and the ATO) with often similar data more streamlined approaches in order

<sup>37</sup> Recommendations 9.1-9.3, 9.11-9.14

<sup>38</sup> Recommendations 9.6-9.8

to reduce information duplication. Whilst SBR is currently a business-to-government application, the Panel recommends that a working group should be established to consider SBR's viability as a business-to-business application.

The Panel believes that all entities that manage or administer a superannuation fund should have the capacity to provide e-commerce facilities to employers of all sizes as a condition of holding a licence. The Panel recommends that employers who fail to use a fund's technology and e-commerce applications (for example by paying contributions by cheque) should be required to pay fees.

Further, the Panel recommends that clearing houses (including administrators offering a clearing house service) should be required to provide linked member and funding data electronically to the fund within two business days of receipt of clean data as a standard licence condition.

**Herbert Geer Comment:**

*Whilst we would consider that most funds would be reliant on e-commerce to reduce costs and enhance member efficiency, total reliance on e-commerce still poses risks where, for example, "fat finger" errors result in under- or overpayments of contributions into a fund or benefits out from a fund. Funds will increasingly need to consider how clauses regarding electronic fraud, mistake and insurance cover affect their contractual arrangements with third parties.*

**9.3 SuperStream and SG payments<sup>39</sup>**

The Panel noted that increasing the frequency of employer SG contributions would potentially compound returns to members and could generate efficiencies if SG payments were made in conjunction with an employer's current payroll obligations. The Panel has therefore recommended that:

- (a) employers should be required to remit salary sacrificed and SG contributions no less frequently than they are required to remit a member's post-tax contributions;
- (b) the timing of payment of SG contributions should be adjusted after SuperStream has been implemented so that SG payments align with member's payroll cycles; and

- (c) on each payslip issued to an employee, employers should be required to report the amount of superannuation to be paid to the employee's fund, whether SG, salary sacrificed or after tax contributions.

**10. REGULATORY SETTINGS**

**10.1 APRA to have standards-making power<sup>40</sup>**

The Panel recommends that APRA should hold a standards-making power that goes beyond prudential matters to focus on transparency, efficiency and outcomes on the basis that standards can be made and varied more quickly than regulations, thereby enabling the regulator, and industry, to respond and adjust to developments within the industry faster.

**10.2 Scale<sup>41</sup>**

The Panel recommends that APRA collects data for the purposes of determining what level of scale is optimal for fund efficiency without expressly making a recommendation as to what size might be optimal.

**Herbert Geer Comment:**

*Whilst the Panel makes no recommendation as to a minimum threshold fund size, it does refer to the fact that in 2008, 70 percent of large APRA funds held less than \$1 billion whilst collectively accounting for only 7 percent of the total net assets of all large APRA funds. The Panel then states its agreement to the view that small funds should be required to demonstrate to APRA why they should remain as stand alone funds, rather than merging before citing estimated cost efficiencies to members of larger (primarily \$2-20 billion funds). The fact that the Panel appears to refer to sub-\$1 billion funds as "small funds" may suggest the Panel envisages a minimum threshold of \$1 billion.*

*As previously stated does this mean that APRA can refuse to register a MySuper fund of less than this minimum and effectively force a consolidation? If so, will it be a reviewable decision pursuant to section 10 of SIS?*

*It seems that the Panel will also give APRA the power to adjust the capital requirements of funds on a risk-weighted basis.*

<sup>39</sup> Recommendations 9.16, 9.17

<sup>40</sup> Recommendations 10.1-10.2

<sup>41</sup> Recommendation 10.3

## 10.3 Ongoing rationalisation<sup>42</sup>

The Panel recommends that SIS should be amended so that the successor fund transfer test is one of “no overall disadvantage”, rather than “equivalence” on the basis that the transfers cannot always address legacy product issues where “equivalence” cannot be achieved. The Panel also recommends that the Federal Court should be given new jurisdiction to determine and facilitate product rationalisation in the superannuation industry where the successor fund transfer regime still does not fulfil legacy product rationalisation objectives.

## 10.4 Capital gains tax rollover relief<sup>43</sup>

The Panel recommends that funds should be afforded the capital gains tax rollover relief granted over the period 30 June 2004 to 1 July 2006 enabling funds that merge to receive rollover relief for gains (rather than only for losses).

### **Herbert Geer Comment:**

*We agree with the Panel's recommendation.*

## 10.5 Member protection<sup>44</sup>

The Panel recommends the abolition of member protection rules on the basis that these rules create cost inefficiencies for funds.

The Panel recommends that eligible rollover fund (ERF) trustees should be licenced and subject to very similar duties as apply to MySuper trustees (bearing in mind ERFs' different functions and characteristics). In order that ERFs more effectively fulfil their intended function:

- (a) the RSE licence for each ERF trustee should be subject to the condition that they actively cross-match with any active funds seeking the service (determine if a lost member's superannuation can be consolidated). All ERF licensees must provide an online facility for people to search for lost super; and
- (b) all funds should be required to cross-match with ERFs for a new member.

## 10.6 Amendments to SIS<sup>45</sup>

The Panel recommends that SIS should be rewritten and restructured to separate and to identify clearly those provisions that are common for all sectors of the superannuation industry and those provisions that are only applicable to particular sectors (such as SMSFs or large funds) under the choice model.

## 10.7 General Employee Entitlement and Redundancy Scheme

The Panel recommends that the General Employee Entitlement and Redundancy Scheme should be extended to cover up to three months of unpaid SG contributions.

## 11. FURTHER DEVELOPMENTS

We will continue to keep you updated as further developments arise.

<sup>42</sup> Recommendations 10.9, 10.10

<sup>43</sup> Recommendation 10.11

<sup>44</sup> Recommendations 10.14-10.16

<sup>45</sup> Recommendation 10.18

This article was produced by Herbert Geer.  
It is intended to provide general information in summary form on legal issues.  
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