

# **Dissenting Report by Labor Senators**

## **Consultation Process**

1.1 At the outset, Labor Senators express their disappointment that these bills were introduced into Parliament on 14<sup>th</sup> September 2017, on a Thursday morning on the last day of a two week sitting period. This was made worse when very short reporting dates were set for not only these bills, but also the Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 2) Bill 2017 and Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Bill 2017.

1.2 Labor Senators also note Senator Gallagher's request in the Senate to extend the reporting date for the three superannuation bills given the complexity of the reforms and note that this motion was voted down by the Senate.

1.3 Labor Senators are concerned that these bills, which claim to improve governance in the superannuation sector, are being rushed through the committee by this Government. What is worse, no clear explanation of the short reporting date was even offered by the Government as a concession. As this report is tabled, it will be three weeks before the first opportunity to debate this legislation in the Senate. These three weeks could have been put to good use.

1.4 Labor Senators thank the Chair of the Committee for allowing two days of hearings to cover the four bills mentioned previously. Labor Senators want to thank Senator Hume and her office for being cooperative despite the unreasonable timeframes set by the Government.

1.5 Labor Senators wish to make the following points about these two bills and at the outset, want to say that Labor Senators reject both bills.

## **Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017**

### ***Introduction***

1.6 Labor Senators are proud of the Labor movement's history in establishing the modern superannuation system.

1.7 Labor Senators are proud of Labor's record in helping to establish industry funds (profit-to-member) – capital and labour at the same board tables, working together to enable workers to have a decent retirement. Labor has a proud record of bringing employers and employees, labour and capital, together to take on challenges of the day.

1.8 Industry funds are an important element of Australia's financial system and they offer alternative ways to run financial services firms. Industry funds, according to

analysis of APRA data by a number of stakeholders, have outperformed retail and corporate superannuation funds on average. It appears that industry funds have done a better job of making their 'customers' rich. Financial services firms worldwide can be prone to making themselves wealthy at the expense of customers, and is stated well in Fred Schwed's well-regarded book titled 'Where are the Customers' Yachts?', first published in 1940.<sup>1</sup> Recent scandals in the banking sector in Australia underscore this problem.

1.9 This competitive tension between industry funds and their trustee governance structure and other financial services firms with their corporate governance structure is a good thing for the sector. Ideally, it should be a race to the top to offer the best outcomes for working Australians. Unfortunately, this government, by undermining industry funds, might be promoting a race to the bottom.

1.10 Labor Senators note 2015 Senate Economics Legislation Committee report into the predecessor of this bill, 'Superannuation Legislation Amendment (Trustee Governance) Bill 2015' and the dissenting report by Labor Senators. Many of the findings in this dissenting report are still relevant and Labor Senators encourage people reading this report to consider the well-made comments set out by Labor Senators in 2015.

1.11 Labor Senators hold the same primary concern with this bill, in that it seeks to impose a corporate governance model on funds which operate under a trustee governance model.

1.12 The primary difference with the 2017 bill is that it has been introduced as a package with other superannuation bills to make the bill look more appealing.

***Problems of corporate governance that are mitigated by the presence of independent directors***

1.13 Corporate governance faces particular issues which need to be addressed and include:

- Board members having a fiduciary duty only to their shareholder owners, which can put at risk the needs of a company's customers; and
- The presence of executive directors, that is, management of the company having a presence on the board, where decisions might be taken that advantage management over the needs of shareholders.

1.14 Labor Senators note that profit-to-member funds do not normally face these same issues. As AIST note, profit-to-member funds do not face the shareholder-customer conflict and also do not have executive directors on their boards.

Prescribing independent directors does not take into account the fact that layers of independence are entrenched within the profit-to-member model,

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1 <https://www.amazon.com/Where-Are-Customers-Yachts-Street/dp/0471770892>

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these layers are: independence from management, structural independence, and independence safeguards derived from the broader regulatory framework.<sup>2</sup>

1.15 The trustee governance model has different governance challenges compared to corporate governance. Independent directors might be a suitable policy for corporate governance risks, but they might not be the best policy solution for trustee governance risks.

### ***Independent directors***

1.16 This legislation, like its predecessor, seeks to prescribe in law a definition for independence.

1.17 The superannuation peak body, ASFA, raised concerns that this approach could prevent a particular individual who could exercise independent judgement from being a director. Instead, ASFA recommended a principles based approach be adopted.<sup>3</sup>

1.18 ASFA went further and also stated that the ASX definition of independence has worked well and there were no systemic issues found with its operation:

I think Australian capital markets and the Australian business community in general enjoy a reasonably high level of esteem internationally, as reflected in the flow of funds that come into this country as investment. Anecdotally, there is no evidence of systemic shortcomings in corporate governance on the basis of that definition.<sup>4</sup>

1.19 In proposing to mandate a minimum percentage of independent directors, the Government expects that decision making on boards will be improved.

1.20 However, witnesses such as Jeremy Cooper and Graeme Samuel stated that what should really be desired in board member selection is the concept of 'cognitive independence', that is, that each board member is able to think independently of other board members, with diversity of thought leading to better group decisions.

Let me say it this way: all of the legislative mechanisms you are looking at will achieve what you might call structural independence, but what you really want is cognitive independence. It's extremely difficult to legislate for the second—it's almost accidental. You only learn that by talking to someone and hearing their ideas and so on. But it's the cognitive independence that you want.<sup>5</sup>

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2 Australian Institute of Superannuation Trustees, Submission 34, p. 6.

3 Association of Superannuation Funds of Australia, Submission 28, p. 4.

4 Dr Martin Fahy, Chief Executive Officer, Association of Superannuation Funds of Australia, Proof Committee Hansard, 10 October 2017, p. 46.

5 Mr Jeremy Cooper, Proof Committee Hansard, 10 October 2017, p. 10.

...the view that I've always had as to 'independent directors' is—I heard Jeremy Cooper just describe it then as the cognitive description of 'independence'—that I prefer to use the qualitative description.<sup>6</sup>

1.21 It is clear from these observations that labels of 'independence' are not the goal. Graeme Samuel made this point very clearly:

You can have as many so-called independent directors as you like, but if the quality of the directors concerned—if their ability to represent a dispassionate view, an objective view, and to have the courage of their convictions—is non-existent, then the independent directors are irrelevant.

1.22 Mr Bernie Fraser made the observation that questions of independence are secondary order issues for profit-to-member funds and that skills and values should be the primary consideration:

The question of independence is peripheral, in my view, compared with those skills and values. If you've got a board table that is comprised, as most not-for-profit funds are, of directors who are committed, who share the values of the members-first approach and who have the skills to make the right decisions most of the time to handle the risks, that is the critical thing. The question of how many of the directors who sit around a board table happen to be independent is peripheral, in my view. It's not germane to the task and the challenges facing all super funds. That's not to say that there's a problem in independence as such—that's fine—but the priorities are the skills and the values. If you can get those from members, that's good. If you have to go outside the representative groups, the employers and the unions, to get the skills—okay, some of those would be independent in terms of the definitions of independence, but the critical thing is the skills and the values.

1.23 The Corporate Superannuation Association also raised concerns about arbitrarily imposing independent directors on some of their members:

The situation where members directly elect their own representatives rather than relying on appointments by unions or other representative bodies, has certain governance benefits arising from the alignment of interests of members and trustee. We contend that where there is immediate member accountability, the best interests of the members are observed. In a fund that is not a public offer fund, we believe that member interests are better served in this way than by statutorily imposed trustee directors who have no connection with the workforce and no prior understanding of the employment situation and the members.<sup>7</sup>

1.24 This legislation also gives significant powers to APRA in deciding whether a board has selected a director who is sufficiently 'independent'. By giving this power to

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6 Professor Graeme Samuel AC, Proof Committee Hansard, 10 October 2017, pp. 15–16.

7 Corporate Superannuation Association, Submission 3, p. 3

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APRA, the Government has further blurred the lines of accountability between ASIC and APRA in regulating corporate governance.

1.25 Given this blurring of responsibilities, Labor Senators echo the Shadow Treasurer's comments that a banking Royal Commission should include in its work a review of the regulatory roles of the RBA, ASIC and APRA in the financial services and banking industries.

### *Independent directors and retail funds*

1.26 Labor Senators are broadly supportive of the FSC's work in establishing a standard for majority independent directors for corporate boards:

We have sought to move the industry towards a higher standard of governance when introduced standard 20, our FSC superannuation governance standard. This requires our member funds to appoint a majority of independent directors and an independent chair, following on from the Cooper review of superannuation. We believe that this sets the high-water mark for corporate governance in the industry and meets the standards set by APRA for all the financial services companies that it covers.<sup>8</sup>

1.27 Labor Senators are also aware of examples where significant banking entities have one governance structure for their retail fund and another for their staff fund. For example, the Commonwealth Bank has a staff fund which has an equal representation trustee model and a retail fund which has a majority independent director model.<sup>9</sup>

1.28 Labor Senators believe that the presence of independent directors hasn't stopped scandals from emerging from some of the for-profit superannuation funds. Industry Super Australia tabled a document claiming that \$480m in compensation, reimbursements, refunds, payments, remediation and consumer loss for alleged misconduct between the big four banks, Macquarie and AMP.<sup>10</sup> This document also includes details of:

- ANZ paying an additional \$10.5m in compensation to 160,000 superannuation customers;
- CBA paying \$16.3m to staff after a review of superannuation guarantee arrangements;
- NAB's superannuation trustee company paying \$35m in compensation for two breaches involving failures in relation to provision of general advice; and

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8 Mr Blake Briggs, Financial Services Council, Proof Committee Hansard, 10 October 2017, p. 19.

9 Table 1, Column E, rows 38 and 41,  
<http://www.apra.gov.au/Super/Publications/Documents/2017-AFLSS-201606.xlsx>

10 Industry Super Australia, Additional Documents, Tabled Document No. 2 at a public hearing in Sydney on 10 October 2017.

- Westpac's BT Financial Group paying \$12 million to customers whose life insurance claims were knocked back.

1.29 Labor Senators believe that independent directors are no silver bullet to problems in the financial services and banking industries.

### ***Mergers***

1.30 The FSC claimed that the presence of independent directors would help with the merging of underperforming default funds:

For example, as detailed in our submission, a major issue facing the industry has been the ongoing resistance of subscale and inefficient funds to resist merging with larger and more efficient funds. This is a major drag on returns for consumers. Our analysis has shown that the average consumer defaulted into a subscale fund as a result of the modern award system and may be as much as \$170,000 worse off by retirement. There are 1.7 million consumer accounts containing \$94 billion currently languishing in the 33 subscale funds in the award system.<sup>11</sup>

1.31 The argument made is that independent directors would act in the interests of members when non-independent directors might be 'conflicted by their relationship to a sponsoring organisation that may want to continue the fund as a going concern'.<sup>12</sup>

1.32 Industry Super Australia refuted this claim and stated that:

Independent directors are no panacea to merger activity. Many independent directors, if they're professional independent directors, owe their livelihood to their directorships. If they're in a situation where a board is merging and their board position no longer is in existence, then they stand to lose financially as a consequence of that. I think it's well worthwhile looking at the detail in the APRA statistics to see the prevalence of small retail funds, which—despite the apparent prevalence of independent directors—are not consolidating at the rate that probably everyone would expect to see.<sup>13</sup>

### ***Removal of requirement for equal representation***

1.33 The bill not only mandates a minimum one-third independent directors, but also goes further by removing the requirement for equal representation. As stated by AIST:

The removal of equal representation from the SIS act is equally concerning to us. The equal representation model of governance has been the

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11 Mr Blake Briggs, Financial Services Council, Proof Committee Hansard, 10 October 2017, p. 19.

12 Mr Blake Briggs, Financial Services Council, Proof Committee Hansard, 10 October 2017, p. 20.

13 Mr Matthew Linden, Director of Public Affairs, Industry Super Australia, *Proof Committee Hansard*, 10 October 2017, p. 64.

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cornerstone of member representation and accountability in the superannuation industry for decades.<sup>14</sup>

1.34 Consumer representative group Choice also shared concerns about possible outcomes of this bill in their submission:

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.<sup>15</sup>

1.35 Choice went further in testimony adding:

We're particularly concerned, given our role as a consumer organisation, about the loss of member representation. This is consistent with our position over time. We've long maintained and supported member participation in the governance of super boards.<sup>16</sup>

1.36 The Australian Council of Trade Unions stated that this measure would be a significant step backwards on fund governance:

You ask the question: is it possible for an organisation to basically hold the other two-thirds of the shares? That is correct. That could happen under the bill. And, if that was the case, then clearly you would have a situation where there was effective control over a company, and the model which I say we have eschewed for 30 years would be the model which took place for a default superannuation arrangement. We think that is inappropriate.<sup>17</sup>

1.37 Labor Senators believe that this move away from the concept of equal representation is an unwarranted step that could have significant adverse outcomes for members.

### ***Trustee Governance***

1.38 Profit-to-member funds have not been idle when reviewing their own governance arrangements. Two pieces of significant work have been carried out in parallel with each other.

1.39 The first is the AIST governance code that will be mandatory for members next year. As stated by AIST in testimony:

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14 Ms Eva Scheerlink, Chief Executive Officer, Australian Institute of Superannuation Trustees, Proof Committee Hansard, 10 October 2017, p. 56.

15 CHOICE, Submission 26, pp. 7–8.

16 Mr Alan Kirkland, Chief Executive Officer, CHOICE, Proof Committee Hansard, 10 October 2017, p. 25.

17 Mr Brian Daley, Australian Council of Trade Unions, Proof Committee Hansard, 10 October 2017, p. 74.

In recognition of this and our commitment to a culture of continuous improvement in governance practices, AIST this year launched a governance code that will be mandatory for more than 50 AIST member funds from 1 July 2018. This builds on a voluntary set of guidelines that we published first in 2011. The code and accompanying guidance are designed to firmly position profit-to-member super funds at the leading edge of international best practice. The code was developed separately but in tandem with the Fraser review and follows a commitment made by AIST and Industry Super Australia to the Australian Senate at the end of 2015. The code mirrors ASX corporate governance principles, applying them obviously in the superannuation context, to reflect an industry that is structured and regulated differently to listed companies. The principles-based code contains 21 requirements that funds must report against annually on an 'if not, why not' basis. These requirements cover member engagement opportunities, equal director voting rights, strong risk culture, board renewal, chair appointment, disclosure, transparency, diversity and remuneration. Member compliance with the code will be monitored by an independent body which can make recommendations to AIST on areas where further guidance may be warranted.<sup>18</sup>

1.40 The second undertaking was the Fraser review, commissioned after the 2015 bill was not passed by the Senate. Mr Fraser was unequivocal in his view that the governance challenges for profit-to-member boards would be in finding people with the right skills and values:

There's always scope to improve things, and these are dynamic things. Funds have been improving. The governance of all funds has been changing and improving over time, and this will continue to be a requirement. But what has really underlined the better performance and the better behaviour of the not-for-profit funds, as I say, has been their values and their skills. They're the critical things that are going to be important in determining the future performance of funds. That's going to be a very challenging circumstance. Investment risks and other risks, as you all know, are increasing. They're on the rise for all kinds of reasons: globalisation, technological changes and geopolitical developments of all kinds. It's going to be more and more challenging to maintain the values. More importantly, maintaining the values in the not-for-profit funds is pretty clear because there are no real conflicts with other parties and other interests. Maintaining the skills and developing the right skill mix—and these are going to be all sorts of skills: technological skills and geopolitical skills, not just financial skills, which have been the focus in the past. Getting those skills and keeping them is going to be a challenge for all funds, including the not-for-profit funds.<sup>19</sup>

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18 Ms Eva Scheerlink, Chief Executive Officer, Australian Institute of Superannuation Trustees, Proof Committee Hansard, 10 October 2017, p. 56.

19 Mr Bernie Fraser, *Proof Committee Hansard*, 10 October 2017, p. 30.

1.41 Labor Senators note the work by profit-to-member funds in improving their governance arrangements and welcome the introduction of the AIST governance code.

*The justification for the requirement of independent directors*

1.42 Several assertions were made to justify the introduction of this bill. Two notable arguments were made at the hearing by Mr Murray AO:

Firstly, we had picked up a model in which employee representatives and employer representatives were present from the defined benefit system.<sup>20</sup>

Next, the governance system is inconsistent with public offer rules under the corporations law and for managed investment schemes.<sup>21</sup>

1.43 In neither case was the argument made that there was a problem with existing governance arrangements in profit-to-member funds. In fact, the balance of evidence suggests, that on average, profit-to-member funds outperform their rivals.<sup>22</sup>

1.44 Regarding the first argument of equal representation and the defined benefit system, it should be noted that Denmark and the Netherlands require equal representation, and are ranked as the top two retirement income systems by the Melbourne-Mercer Global Pensions Index.<sup>23</sup>

1.45 Mr Cooper gave evidence to suggest that the Netherlands were moving away from strict equal representation:

Leading pension systems are actually moving away from the strict equal representation model and are putting independent directors on their pension schemes—most notably—and, I suppose, of most relevance for Australia, the Netherlands, which is seen as being in the elite top two of pension systems.<sup>24</sup>

1.46 In questions on notice to this committee, Industry Super Australia responded, saying that the move by the Netherlands towards independent directors was a voluntary suggestion that boards could adopt if they believed that it was in the interests of their members:

In 2014 the Dutch Labour Foundation (a joint union-employer body), in collaboration with the Federation of the Dutch Pension Funds, published a new ‘Code of the Dutch Pension Funds.

This Code contained suggestions for how Dutch pension funds could model their governance arrangements. These suggestions included giving

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20 Mr David Murray AO, Proof Committee Hansard, 10 October 2017, p. 1.

21 Mr David Murray AO, Proof Committee Hansard, 10 October 2017, p. 2.

22 Industry Super Australia, Tabled Document 3, tabled at a public hearing in Sydney on 10 October 2017.

23 Industry Super Australia, *Submission 8.1*, p. 13.

24 Mr Jeremy Cooper, Proof Committee Hansard, 10 October 2017, p. 8.

consideration to appointing 1 or 2 external/independent members to a board if a fund believed such appointments would be in the best interests of members.

The Code is principles-based and does not prescribe appointing external members. Funds can adopt some, all or none of the Code depending on their particular circumstances. Where funds have complying equal representation arrangements, they are free to continue with those arrangements if they believe them to be in the best interests of members.<sup>25</sup>

1.47 Regarding the second argument of rules in other laws, it does not seem clear that rules under corporations law and for managed investment schemes should automatically inform governance structures in the superannuation industry, particularly when there is no identified problem to solve.

1.48 Academics have also stated findings in their research raising doubts about the link between the presence of independent directors and fund performance. In particular, Dr Kevin Liu found that:

There is insufficient empirical evidence supporting a (statistically and economically) significant relationship between a higher number (and proportion) of 'independent directors' and better fund performance.<sup>26</sup>

1.49 Dr Scott Donald also found that:

Research I conducted with Associate Professor Suzanne Le Mire in 2015 found little empirical evidence that structural independence measures such as those envisaged in the Independence Bill are associated with higher investment returns or lower risk, the usual metrics of performance in the superannuation and pensions domain globally.<sup>27</sup>

1.50 Given the evidence received by this committee, Labor Senators believe that there is insufficient evidence to establish that a problem exists in Australian superannuation governance that warrants legislative change and that the presence of a proportion of independent directors can be linked to improved fund returns. The justification for this legislation is very weak.

### ***Labor Senators' position on this bill***

1.51 Labor Senators believe that no clear evidence has been offered to demonstrate why these changes are necessary. A Government which purports to be conservative, non-interventionist and pro-market would be expected to introduce additional regulation only where there is evidence of clear market failure.

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25 Industry Super Australia: Answers to questions taken on notice from a public hearing on 10 October 2017 (received 17 October 2017)

26 Dr Kevin Liu, Submission 36, p. 2

27 Dr Scott Donald, Submission 24, [p. 2].

1.52 This bill would disproportionately impact profit-to-member funds when evidence suggests it is the retail and banking sectors which need Government focus.

1.53 Labor Senators are not opposed to independent directors as a principle. Where trustee boards believe that independent directors would enhance board decision making they should be appointed. Many profit-to-member funds have adopted such appointments. However, Labor Senators do not believe in prescribing an arbitrary quota of independent directors and defining independence in legislation. Labor Senators welcome the work of AIST in developing a governance code and endorse the idea that 'cognitive independence' is what policy makers should strive to achieve.

1.54 Labor Senators also have a preference to focus on 'outcomes' in superannuation (for example, net returns to members), rather than 'inputs' such as the number of independent directors. An outcomes approach enables different funds to pursue different business models in the pursuit of outcomes such as net returns to members.

1.55 Labor Senators remained concerned that the primary intent of this bill might not be related to policy matters.

### **Recommendation 1**

#### **1.56 To oppose the Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017**

#### **Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017**

##### *Introduction*

1.57 As set out in the Explanatory Memorandum – this bill has a number of schedules and is a dense piece of legislation. Before commenting on specific schedules, Labor Senators would like to express a number of high level comments.

1.58 Labor Senators are concerned that this legislation will not improve protections, accountability and outcomes for all members across the sector.

1.59 In particular, the need to strengthen outcomes for Choice products and to improve the reporting and accountability of retail RSEs with a large financial firm parent company have not been given due consideration in this bill.

##### *The need for stronger protections for both MySuper and Choice products*

1.60 Mr Cooper agreed with the assertion that his notable recommendation for the establishment of a MySuper product would act as a well performing default product. Choice products would have to compete against this high bar.

Senator KETTER: Let me just ask you: would you envisage MySuper being a strong default product with the view of setting a high bar for competition,

and that choice products need to compete against this MySuper high bar by offering stronger net returns to get people to switch?

Mr Cooper: Yes, I would.<sup>28</sup>

1.61 The assumption in this thinking is that people have full information and are able to use that information to act in their own best interests – evaluating the returns on their default product, finding a choice product that offered some combination of stronger net returns and other benefits and then making the switch.

1.62 However, a recent Rice Warner report commissioned by Industry Super Australia finds that the evidence suggests that this is not what is occurring in practice. It would appear that people are increasingly switching to products that are more costly and have poorer returns.<sup>29</sup>

1.63 The Rice Warner report notes that:

Members are unlikely to have used fee levels as a primary reason for switching between funds, as many members are charged a higher fee after switching... The aggregate fee outcomes from switching activity reveals a net increase of \$137 million in fees.

Members are unlikely to have used past performance as a proxy for their investment decision as the data shows on average that historical returns for the incumbent and successor fund tend to be similar.

36% of members would have received higher returns over the period, while 56% of members would have received lower returns. 8% of members did not see a notable increase or decrease in investment performance (with a margin of 0.05% either way).

The aggregate estimated impact on investment returns reveals a net decrease of \$284 million annually. This is largely driven by a \$373 million decrease in returns annually for members rolling into funds with lower returns. Retail funds accounted for 87% of this decrease in returns.

1.64 These findings raise significant questions about the ability of consumers to effectively compare across superannuation products.

1.65 Given the findings that many members are switching to lower performing products, Labor Senators believe that there needs to be stronger protections for both MySuper and Choice products.

1.66 This view is also endorsed by the Financial Services Council:

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28 Mr Jeremy Cooper, Proof Committee Hansard, 10 October 2017, p. 11.

29 Industry Super Australia, *Submission 20.1*, pp. 30-31 (to inquiry Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 2) Bill 2017)

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The FSC supports higher standards of governance, transparency and accountability for both choice and MySuper products.<sup>30</sup>

### ***Retail fund performance***

1.67 Objections are often made when the claim that industry funds outperform retail funds, citing asset allocation and a difference in member demographics:

And the result of that is that the returns will inherently be lower because you have more in cash, more in bonds and less in growth assets. ISA will say, 'Therefore, you're a badly-performing fund.' But if I were a 75-year-old and I had a high-risk asset allocation, and we had something like the global financial crisis and I lost 30 or 40 per cent of my investments then I wouldn't have thanked the trustees in their decision. In fact, I would be wishing that there were independent directors on the board saying that it was more important to make the right investment decisions for my circumstances than it was necessary to top the league tables so they could defend our brand.<sup>31</sup>

It's not just the governance structure; it's the underlying assets and investment strategy and the composition; it's the demographics; and it's the range of products. You've got a number of different features that are within any RSE. So comparing at fund level, and particularly comparing averages by sector, is just not meaningful.<sup>32</sup>

1.68 Both AIST and ISA offered criticisms of those claims—citing that their two percentage point performance advantage<sup>33</sup> over retail funds could not be fully explained by these issues.

1.69 Industry Super Australia in response to Questions on Notice cited evidence to show that the difference between Industry fund and Retail fund cash options (simple asset, easy to compare) still had a difference in returns of 0.8 per cent to 1.5 per cent.<sup>34</sup>

1.70 In testimony to the committee, AIST noted that:

Research that AIST commissioned earlier this year showed that the choice sector underperformed generally across like-for-like asset allocations compared to MySuper asset allocations and that fee structures were

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30 FSC, submission 27, pg. 1, (to inquiry Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 2) Bill 2017)

31 Mr Blake Briggs, Financial Services Council, *Proof Committee Hansard*, 10 October 2017, p. 22.

32 Mrs Helen Rowell, Deputy Chairman, Australian Prudential Regulation Authority, *Proof Committee Hansard*, 10 October 2017, p. 89.

33 Industry Super Australia, Tabled Document 3, tabled at a public hearing in Sydney on 10 October 2017.

34 Industry Super Australia, Additional Document 7 – QoNs for public hearing held on 10 October 2017

between 53 and 280 per cent more expensive in the choice sector. So we are concerned that this remains. In addition to that, all retiree money is in the choice sector. That is another very important reason that that be captured. That's our basic view in relation to choice.<sup>35</sup>

1.71 Labor Senators also note that Treasury have not undertaken work themselves to understand these claims:

Senator KETTER: Thank you. Has Treasury done any analysis on what's driving the difference in performance in terms of net returns between the different types of super funds?

Mr Beckett: We haven't done any analysis ourselves.<sup>36</sup>

1.72 Labor Senators remain concerned that issues of asset allocation and member demographics do not completely explain the gap in average fund performance.

1.73 Labor Senators would also encourage Treasury officials to use publically available APRA data to explore these issues and report to the committee on its findings.

### ***Comments on the schedules in this legislation***

#### *Schedule 1 - Annual MySuper outcomes assessment*

1.74 Labor Senators welcome the introduction of an outcomes test to replace the scale test.

1.75 Labor Senators note ISA's analysis that indicates that the benefits of scale are not accruing to members of all funds.<sup>37</sup> Figure 1 indicates that there are large funds operated by Westpac, ANZ, CBA, AMP and NAB which are clustered around the bottom quartile of performance. As scale remains as one factor in the outcomes test, this issue should be addressed.

1.76 ISA in their submission also noted that an outcomes test should also place as primary important the outcome of net returns to members.

1.77 Concerns were also raised that the MySuper outcomes test would be prescribed in legislation, whereas APRA has only committed so far to consulting on proposed changes to prudential standards to include an outcomes test for Choice products.

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35 Ms Karen Volpato, Senior Policy Adviser, Australian Institute of Superannuation Trustees, Proof Committee Hansard, 10 October, 2017, p. 66.

36 Mr Ian Beckett, Principal Adviser, Retirement Income Policy Division, Department of the Treasury, Proof Committee Hansard, 10 October 2017, p. 82.

37 Industry Super Australia, *Submission 8*, p. 6.

1.78 Labor Senators believe that an outcomes test should apply to all products, not just MySuper products.

*Schedule 2 - Authority to offer a MySuper product*

1.79 Labor Senators note concerns that APRA's proposed authority is different to its authority to refuse an RSE license, giving the appearance that there are different protections for those with MySuper products compared to Choice products.

*Schedule 3 - Director penalties*

1.80 Labor Senators note concerns from stakeholders about:

- Whether penalties should be extended to directors of superannuation funds that offer Choice products<sup>38</sup> (AIST)
- The proposal exposed superannuation trustees directors to greater risk of personal liability than other company directors<sup>39</sup> (Mercer)
- Whether a set of protections, such as good faith actions, should be considered<sup>40</sup> (ASFA)
- The interaction of the directions power with these penalties<sup>41</sup> (AICD)

*Schedule 5 - APRA directions power*

1.81 Labor Senators note concerns raised by a variety of stakeholder that APRA's proposed powers are too broad. As ASFA stated in their submission:

In particular we question the breadth of the proposed APRA directions powers and whether they could be more precise<sup>42</sup>

1.82 AIST also raised concerns that the directions power does not adequately consider the corporate structures of the retail fund sector:

While we support the expansion of the directions power to cover connected entities, the current provision is fundamentally flawed because it does not have consistent application across sectors of the superannuation industry – notably, superannuation funds operating in a retail environment would attract less scrutiny.<sup>43</sup>

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38 Australian Institute of Superannuation Trustees, Submission 34, p. 16.

39 Mercer, Submission 16, p. 1.

40 Dr Martin Fahy, Association of Superannuation Funds of Australia, Proof Committee Hansard, 10 October 2017, p. 48.

41 Australian Institute of Company Directors, Submission 21, p. 7.

42 Association of Superannuation Funds of Australia, Submission 28, Attachment 1, p. 2.

43 Australian Institute of Superannuation Trustees, Submission 34, p. 22.

*Schedule 6 - Portfolio holdings disclosure*

1.83 ISA raised the concern that 'this Bill seeks to amend the current requirements so that the disclosure requirement does not apply to choice products that contain multiple investment options (an intrinsic feature of platform products).'<sup>44</sup>

1.84 Treasury officials responded to this concern by stating 'I would like to make a very brief opening statement simply to confirm that there is no platform carve-out in the portfolio holdings disclosure provisions'.<sup>45</sup>

1.85 Labor Senators note the Treasury's advice that the portfolio holdings disclosure requirements in this Bill will cover platform products.

*Schedule 7 - Annual Member's Meetings*

1.86 Labor Senators note the number of submissions that raised concerns about the prescriptive nature of the requirements of an Annual Member's Meeting and whether the cost of running these meetings would be outweighed by the benefits of practical member engagement.

*Schedule 8 - Reporting standards*

1.87 Labor Senators endorse the concept of improving transparency to members.

1.88 Labor Senators note that some funds are currently reporting zero investment fees and expenses under current reporting standards.<sup>46</sup>

1.89 Labor Senators call on the Government to fix the current reporting regime before introducing new reporting requirements.

1.90 Labor Senators call on the Government to end the five year deferral on the rollout of choice product dashboards.

***Labor Senators' position on this bill***

1.91 Labor Senators believe that there needs to be proper protections for both MySuper and Choice products. Given the findings in the Rice Warner report, it is likely that customers are not being provided easy access to sufficient information so as to enable ready comparison of products.

1.92 Labor Senators believe that this bill fails to sufficiently strengthen protections and outcomes for choice products and to sufficiently increase scrutiny of retail funds.

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44 Industry Super Australia, *Submission 8*, p. 21.

45 Mr Ian Beckett, Principal Adviser, Retirement Income Policy Division, Department of the Treasury, Proof Committee Hansard, 10 October 2017, p. 81.

46 Industry Super Australia, *Submission 8*, pp. 15–18.

1.93 When considered alongside the trustee arrangements bill, Labor Senators are concerned that the primary intent of this bill might not be related to policy matters.

**Recommendation 2**

**1.94 To oppose the Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017 unless the bill applies consistently and comprehensively across the superannuation system.**

**Senator Chris Ketter**  
**Deputy Chair**

**Senator Jenny McAllister**  
**Senator for New South Wales**

