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## ON THE COVER









## REGULARS

# State **of super**

**Dr Martin Fahy**

ASFA Chief Executive

The last year has been a particularly stormy one for superannuation and it has left many people a little disoriented. Now that the deluge has passed we paradoxically have a clear and uncluttered view of what our strengths and weaknesses are and where we are heading, the looming federal election notwithstanding.

So, where do we stand in the aftermath of the Productivity and Royal Commissions and the varying success of the Government's legislative measures?

The first thing that strikes me in surveying the aftermath, and I am conscious that many observers would find what I'm about to say surprising given the nature of the public debate in recent times, is that Australia is tantalisingly close to having one of the best retirement systems in the world. Many studies have reached this conclusion and the recent OECD Pensions Outlook publication is another reminder of the virtues and benefits of our system. The report finds that the Australian system is equitable, affordable or fiscally sustainable and well designed. The area where Australia does not do so well is adequacy of retirement incomes which is directly correlated to our relatively low level of contributions, another reason to move to an SG rate of 12 per cent.

On the other hand, we must acknowledge the existence of underperformance, however that is defined, and I think that the attention that the Commissions drew to this subject will continue. There appears to be broad support for reform and the need for improvements in this area and enormous pressure will be placed on funds perceived to be underperforming to lift their game or leave the game if they can't. In practice this could be a disorderly process and we need to establish the tramlines for remediation or resolution or define them much more clearly than they are at present. Everyone has been focused on the 'what' up to this point, but they now need to focus on the 'how'.

For the funds that are performing well there will also be changes as they are pushed to demonstrate their value proposition to members. The existing bias to scale will become more accentuated because of the growing need for capability, investment capability in areas such as alternative assets and the international deployment of capital, and operational capability, in particular the capacity to deal with the ever-growing regulatory and reporting burden.

At the same time funds, especially small to medium sized funds, will have to differentiate and show that their product offering is uniquely tailored to the needs of their membership. A big part of targeting value to members will be group insurance which Commissioner Hayne appears to support, even though he scarcely turned his attention to it during the hearings. Along with the recent amendments made to the Protecting your Super package the future of group insurance appears to be secure, at least in the medium term, and funds now have an opportunity to use it to cement their value proposition to members.

Another area which funds can use to establish their niche value offering is financial advice. I believe that the provision of financial advice will bifurcate between a low cost, digital service; and the more traditional personal offering but which is also more expensive. However, I am not convinced that most members won't pay for financial advice. You just have to look at our use of the internet where people are moving quickly from casual piracy to happily paying for their films, music, sport and news. The important thing is establishing value and at the right price point and the evolution of advice will have to better match services to members' willingness to pay for those services.

The impact on the regulators will, in my view, be more complicated. The current regulatory architecture will survive but the style, the cadence of regulatory oversight will change substantially. The demands for timely data from funds will increase and it will be an enormous challenge for the regulators to filter that information, to locate the music in the noise. The idea that more data is intrinsically beneficial is based on a flawed epistemology but that won't stop the regulators asking for it. We must hope that they can use it sensibly, but I think it more likely that they will simply be overwhelmed.

The regulators' tolerance for error is also likely to diminish. We are moving from a world where elegant strategy was admired and sometimes used as the basis to explain mistakes to one of flawless execution where errors, even small ones, will not be countenanced. To achieve this, funds could look to other industries where for health or safety reasons errors are simply not permissible and where evidentiary assurance is commonplace. Industries such as pharmaceuticals where for good reason faults in measurements are not permitted, mining where large operations will be brought to a standstill for the most minor health and safety breach or the aeronautics industry where safety is happily paramount.

Our current approach of accepting or at least tolerating amateurish processes and systems has got to change. For example, we will no longer be able to accept elderly, creaky and multi-layered administration systems with the occasional spreadsheet to fill in the gaps, on the basis that if anything goes wrong the affected members will be compensated in due course.

While a person's life may not be at stake because of an incorrect unit price or a faulty tax calculation we can no longer afford such an easy-going, she'll be right style. The regulators won't stand for it, increasingly members won't tolerate it, and—in a world where personal attestations will increasingly be required—super fund staff won't accept it either.

In this safety-first environment, the regulators will also need to work out how to deal with innovation and disruption or we will miss out on the benefits they can bring. This is already a difficult area for the regulators, and they will have to ensure that in the process of enforcing seamless and faultless processes they don't suppress new entrants and digital enterprises which are inherently riskier than the tried, if occasionally a little tired, and true.

There is unfortunately no time for complacency. We are living in a petulant, hyper-sensitive political environment and the risk of rash or excessive policy ideas is high and the threat to the basic tenets of superannuation, universality and compulsion, is real. We all need to lift our game, but we also need to deal with potentially unreasonable expectations about those identified as underperformers so that an orderly resolution can be achieved for funds and members. There also needs to be a new understanding and relationship built between the regulated and the regulators, and the potential for misunderstanding, inefficiency and bad blood needs to be avoided.

So what is the state of super in Australia? There is much to do. There's much we in the industry can do to make improvements, and we must also acknowledge our reliance on others, the government and the regulators, to bring about the necessary changes. However, as I said at the beginning, we are tantalisingly close to being one of the best retirement systems in the world and while we work to improve it, we also need to recognise its fundamental strength – that it is delivering for its members. SF

HEADLINES

## legalsuper re-appoints fund administrator Link Group

After its fifteen-year association, legalsuper has announced the re-appointment of Link Group as its fund administrator following a rigorous competitive review.

According to legalsuper's chief executive, Andrew Proebstl, the fund used assessment criteria covering: organisational strength, technology infrastructure, service, compliance and experience, pricing, and strategic compatibility in determining the best administrator for legalsuper.

"As our members continue to become more engaged with their super, and as a result seek higher levels of service, support and information, we need to ensure we take full advantage of continuing developments in technology infrastructure and capabilities to meet these expectations," Proebstl said.

Link Group managing director, John McMurtrie said "legalsuper is a key client of Link Group and we have enjoyed working with them to achieve their strategic objectives in the legal and professional services industries".

## Leadership development scholarships available

Building on the significant developmental momentum achieved during the 100 Days for Change campaign last year, Women & Leadership Australia is administering a national initiative to support the development of female leaders across the finance sector.

The initiative is providing women with partial grants of between $3,000 and $7,000 to enable participation in a range of leadership development programs.

The scholarship funding is provided with the specific intent of providing powerful and effective development opportunities for women across the sector; however the funding is strictly limited and has to be allocated prior to the end of March.

Find out more and register your interest by completing the Expression of Interest form here prior to March 15th: www.wla.edu.au/finance

## Global survey shows work life balance and rapid career progression rank with salary

Work life balance involving flexible working arrangements is nearly as important as salary amongst young graduates seeking professional positions, according to a global survey conducted by the CEMS Global Alliance of Business Schools.

The survey of more than 750 recent graduates in nearly 60 countries also found that the promise of rapid career progress and an opportunity to make an early impact were significant factors when choosing a career path.

Three quarters of respondents, the majority in their early twenties, expected to have an executive level role within 10 years or less while 25 percent expected to achieve this level within five years.

The chair of CEMS and Dean of the University of Sydney Business School, Professor Greg Whitwell noted:

"While being highly motivated and ambitious, these young people also want to lead balanced, well rounded lives and, importantly, they want to make a positive impact on the lives of others."

When asked about the skills they felt would be necessary as technology developed in the workplace, the graduates ranked social skills such as persuasion, emotional intelligence and empathy as most important followed by people management skills including team leadership and motivation.

These were ranked above hard skills including formal qualifications, data analysis and cognitive abilities such as creativity and mathematical reasoning.

"It is important that organisations take note of these insights if they are to benefit from the ambition of our graduates and gain competitive advantage in an uncertain age," Siegers said. "This means giving young people an opportunity to tackle projects that deliver real global impact as early as possible while recognising their need for a life outside of work."

## ASFA Policy Update

**The Royal Commission**

- The Royal Commission released its final report on 4 February.
- There are a range of recommendations but those relating to superannuation were targeted and relatively moderate.
- The Government, Opposition and ASIC have all released further detail about their responses to the Royal Commission into misconduct in the banking, superannuation and financial services industry.
- ASFA is consulting with members on the details of the recommendations, such as single default for life and restrictions on advice, as we prepare our response.

**Productivity Commission**

- The Productivity Commission released its final report into on 10 January 2019.
- The Productivity Commission has left its primary recommendations unchanged. These include:
    - A top ten 'best in show' model for default funds
    - Defaulting only once for new entrants to the workforce, which was picked up by the Royal Commission
- ASFA is concerned about the effect a top ten model would have on competition and innovation.
- ASFA has supported 'lifting the bar' rather than introducing the recommended 'Top 10 Best in Show'.
- ASFA is consulting with members on developing an appropriate and feasible approach as to how MySuper products could be assessed.

**Dispute resolution**

- ASIC's consultation on reforms to internal dispute resolution arrangements has been deferred until late March/early April.
- Both the Government and Opposition have made announcements about expanding consumers' access to AFCA, in light of the Royal Commission. ASFA is seeking to confirm any impact on superannuation complaints.

## ASFA SUBMISSIONS

ASFA's policy team has been working on a number of submissions lately. The most recent are:

- Submission to The Treasury
  ASFA response to Consultation Paper: Review of the early release of superannuation benefits
- Submission to the Senate Economics Committee Inquiry into Social Services and Other Legislation Amendment (Supporting Retirement Incomes) Bill 2018
- Submission to the Australian Law Reform Commission
    - Review of the Family Law System – Discussion Paper 86 – issues with respect to superannuation
- Submission to the Productivity Commission:
    - ASFA response to the Supplementary Paper – Investment performance: Supplementary analysis
- Submission to the House of Representatives Standing Committee on Economics:
    - Inquiry into the implications of removing refundable franking credits
- Submissions to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry:
    - Response to the Interim Report – issues with respect to regulation and the regulators
    - Response to Round 6 insurance in superannuation policy questions
    - Response to Round 5 superannuation policy questions
- Submission to the Treasury on the work test exemption for recent retirees – draft legislation and regulations

# INDUSTRY MOVEMENTS

## AMP announces new board appointment

AMP has appointed Andrea Slattery to its board as a non-executive director, effective 15 February 2019.

Slattery has 26 years' experience in financial services, superannuation and retirement including establishing and leading the SMSF Association.

In addition to her experience as a managing director and CEO, Andrea has served on high-profile board and advisory committees for listed companies and in the commercial, government and not-for-profit sectors.

Slattery is currently a non-executive director at Clean Energy Finance Corporation, Argo Global Listed Infrastructure and the South Australia Cricket Association.

## Sunsuper reshapes executive team

Sunsuper has announced changes to its executive team to allow the fund to effectively execute its ambitious growth strategy.

The changes align with the fund's strategy to increase its focus on a data-driven, digital-direct consumer strategy while maintaining the strong growth and momentum the fund has experienced in the corporate super, retail distribution and SME space.

The new structure marks the promotion of Petrina Weston, David Woodall, Danielle Mair and Stevhan Davidson to the executive leadership team. The new executive team structure will take effect from 1 March 2019.

Michael Mulholland however has decided to leave Sunsuper after nearly five years with the fund to spend more time in Sydney with his family. CEO Scott Hartley, the executive team and the whole Sunsuper team wishes him well in his future endeavours. Mulholland will remain at Sunsuper until 15 March to ensure a smooth handover.

## Changes to Qantas Super board

Qantas Super has announced that Anne Ward has decided to step down from the fund's board at the end of May 2019 after 15 years of dedicated service to Qantas Super, 14 of those as chair.

Qantas Super's chief executive officer Michael Clancy thanked Ward for her unwavering commitment over the years, acknowledging her extensive experience in the financial services sector and as a professional company director. He said she "has guided Qantas Super through market cycles and substantial regulatory change to leave the fund in great shape for the future".

Qantas Super has also announced the appointment of two new company-appointed directors designate, John Atkin and Lorraine Berends. They will fill the vacancies left by Ward and former director, Paul Costello, who sadly passed away in November 2018.

## CEO AND chairman to leave NAB

National Australia Bank chief executive officer Andrew Thorburn and chairman Dr Ken Henry have advised they will leave the bank. The NAB Board will initiate a global search process for the CEO role while actively considering a range of quality internal candidates. Thorburn will finish at NAB on 28 February 2019. Dr Henry indicated he would retire from the board once a new permanent CEO had been appointed.

## Statewide Super announce new CEO

Statewide Super has announced that Tony D'Alessandro will be the new chief executive officer, effective 1 March 2019. D'Alessandro will replace Richard Nunn, who in January announced his appointment as CEO of MetLife Australia, resigning from Statewide Super after more than three years in the role.

D'Alessandro has significant experience in private banking, wealth management (financial planning, insurance and superannuation) and administration, having held a broad range of senior executive management positions for CBA, St George Bank and Bank SA. Currently in the role of general manager, member engagement for Statewide Super, D'Alessandro's appointment followed careful consideration by the board of the existing succession plan.

The chairman of Statewide Super, Ken Williams said: "Tony has been an integral member of the Statewide Super leadership team for the past three years. His natural ability to develop and inspire high performing teams and winning cultures, allows him to skilfully lead business progress at every opportunity."

Incoming chief executive officer D'Alessandro said: "It is a privilege to be appointed to lead Statewide Super, as we continue to deliver exceptional outcomes for our member's retirement income goals. No Australian should be deprived of the opportunity to live a dignified retirement, and this will be my key driver."

## AvSuper announces new chair

AvSuper has announced the appointment of Ben Firkins as the new chair, effective 1 February 2019, following the retirement of George Fishlock after 19 years of service to the fund.

"On behalf of the fund staff and members, we thank George for his dedicated service and leadership of the fund and the continuing focus on 'members first,'" said Firkins.

Michelle Wade, AvSuper's CEO said, "We welcome Ben's election to the role of chair and are looking forward to his leadership of the fund. Ben's experience in the aviation industry and in AvSuper make him ideal to lead our aviation based and member focused fund into the future."

## UniSuper announced new appointments

UniSuper has appointed Penny Heard as portfolio manager in the global strategies and quantitative team, and Lou Caparrelli to the position of manager, sustainable portfolios and governance.

Heard brings over 15 years' experience to the role, joining from JCP Investment Partners where she was a senior portfolio manager and research analyst. Prior to this she held senior roles with Bank of America Merrill Lynch in Australia and Hong Kong.

Speaking of the appointment, UniSuper's chief investment officer John Pearce said that "her appointment adds to the considerable talent we have been able to attract from other funds and investment banks over recent years, which has enabled us to expand the scope of our in-house management activities".

Caparrelli is a member of UniSuper's Australian equities team with extensive experience in the Australian market, including senior roles at Blackrock and Evans and Partners.

Pearce said: "ESG teams are typically staffed by people who do not have direct portfolio management responsibilities, so Lou's appointment places us in a relatively unique position in the industry. His appointment is testament to how committed we are to factoring environmental, social, and governance considerations into the investment process."

# MARCH 2019

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|---|---|---|---|---|---|
| 05 TUE | **VIC I WA** Risk and Compliance Discussion Group | 07 THU | **VIC** Fund Taxation Discussion Group | 12 TUE | **VIC** Investment Discussion Group<br><br>**NSW** Legislation Discussion Group |
| 13 WED | **Sydney** RG 146 Superannuation Three-day workshop | 14 THU | **National** Financial Crime Discussion Group | 18 MON | **VIC** Legislation Discussion Group |
| 19 TUE | **Melbourne** RG 146 Superannuation Refresher | 21 THU | **New South Wales** State Conference | 22 FRI | **Sydney** Core Governance for Superannuation |
| 26 TUE | **NSW I VIC** SMSF Discussion Group<br><br>**Sydney** RG 146 Superannuation Refresher | 27 WED | **VIC I WA** Member Services Discussion Group<br><br>**NSW** Innovation Discussion Group<br><br>**QLD** General Discussion Group | 29 FRI | **Brisbane** RG 146 Superannuation Refresher |

# APRIL 2019

| | | |
|---|---|---|
| 02 TUE — **VIC I WA** Risk and Compliance Discussion Group | 03 WED — **Sydney** Budget Briefing | 04 THU — **Brisbane** Budget Briefing<br>**VIC** Fund Taxation Discussion Group |
| 05 FRI — **Melbourne** Budget Briefing | 08 MON — **Perth** Budget Briefing | 09 TUE — **Adelaide** Budget Briefing<br>**NSW** Legislation Discussion Group |
| 16 TUE — **VIC** Member Insured Benefits Discussion Group | 17 WED — **VIC** Innovation Discussion Group | 22 MON — **VIC** Legislation Discussion Group |
| 24 WED — **VIC I WA** Member Services Discussion Group | 30 TUE — **VIC I WA** SMSF Discussion Group | |

Events | Learning courses | Discussion Groups | *Superfunds* deadlines

*See the ASFA website for more information/to register. Dates subject to change.*

# Could venture capital be the key to super funds' survival as borrowed time comes to an end?

**Benjamin Chong**

Partner,
Right Click Capital

When Paul Keating kicked off compulsory superannuation contributions in 1992 at a modest 3 per cent, few would have foreseen that it was the birth of one of the most inclusive, and in the years to follow, one of the largest retirement savings systems in the world.

Fast forward 27 years and Australia's superannuation system is now worth an estimated $2.7 trillion and is ranked as the fourth best in the world behind the Netherlands, Denmark and Finland. It also represents one of the fastest-growing retirement funds globally, currently at around 130 per cent of GDP. With compulsory contributions legislated to increase to12 per cent by 2025-26 there have been estimates that the pot could quadruple in size in the next 10 to 20 years.

But while the size of the pot and participation rate are world-leading, superannuation funds have never faced more intense scrutiny than at present. There is a growing view that the current superannuation default system is grossly outdated and awash with under-performing funds who need to shape up or ship our money out to funds with better returns.

The Hayne Royal Commission shone a spotlight on this poor performance in addition to highlighting the colossal amount of super that has been eroded by excessive administration fees and insurance add-ons. Indeed members of a number of managed funds would have been better off with their savings under the mattress. With the Productivity Commission now demanding an inquiry into the total retirement incomes system, it seems that superannuation funds will need to change their ways if they are to survive.

But this shouldn't come as a surprise to anyone. There has long been a significant problem with the way that super funds are investing members' money. Australia, even with its supposedly progressive retirement savings system, is lagging in comparison to its global counterparts where allocation to private credit, infrastructure, hedge funds and private equity, including venture capital are all increasing. The $2.7 trillion available to invest is larger than the capitalisation of the Australian stock market and unfortunately this is where approximately a quarter of our retirement savings are going. In a buoyant market this may be well and good but against the backdrop of sliding global markets, this has been disastrous for fund value. The ASX was down 7 per cent in 2018 and the sell-off has continued into 2019 with a bleak outlook for the remainder of the year. If funds are to survive in the post-royal commission era a radical overhaul of their investment and management strategy is unavoidable.

To date, Australian super funds' asset allocation to venture capital have been slow on the uptake. Of the $2.7 trillion in Australia's retirement pot, just 1.4 per cent has been allocated to private equity, and much less in venture capital. Of course, there are outliers such as Australian Ethical and HostPlus who have considerable exposure to venture capital in comparison to their peers. But there is still room for improvement.

One exception is the Australian Government's Future Fund. In 2018, the Future Fund allocated more than 4 per cent of funds to venture capital and returns over the seven years to September 30, 2018 averaged 10.7 per cent. The venture capital and growth equity component of this fund in isolation increased by 23.3 per cent.

Venture capital is, of course, not the only asset class that is uncorrelated to bonds and equities but there are numerous other reasons that venture capital deserves a place at the top table of the super funds. Ten years ago, there was only one tech company in the world's top ten companies by market capitalisation. Now there's six. Whether the six can maintain their rates of growth is yet to be determined, but we know that tech will continue to be of fundamental importance to the world's economies. The smart investors know they need to access tech at the early expansion stage to capitalise when these companies eventually list, at often hefty valuations.

For those of us making the decisions on which early stage companies to invest in, it's clear that the opportunities are abundant, and venture capital is undercapitalised. We want to see more Australians as creators of technology, not just as customers or consumers. This is vital for the future of the broader Australian economy. The lack of funds is a problem that can be easily solved when we look at the growing retirement pot and Australian super funds fight for survival. SF

Michael Schwarz and Maree Pallisco

Narelle Burt, Sarah Goodwin and Susan Stephenson

# Federal Election Briefing

## Melbourne

**12 February**

James Dixon, Owain Norman and Adrian Gut

**Photography:**
*Lisa Saad*

Steve Collins, James Bennett and Louise Charsley

Tyler Flavel, Scott Jarett, Kerrina Lawrence and Benedict Davies

Silvano Andreoli, John Robinson and William Hodges

Shaun Cartoon and Janine Wright

Kerryn Lancaster and Ross Kimberley

# **The reform agenda:** The Royal Commission and super Bills

JULIA STANNARD reports on recent legislative and regulatory news and developments affecting the superannuation industry.

The landmark final report from the banking and financial services Royal Commission sets out a blueprint for substantial reform of the industry that is likely to be embraced by both sides of politics as we move toward the upcoming election. Meanwhile, the Government has forged ahead with its legislative agenda despite challenges in the Senate. Important progress has been made on some superannuation bills while others remain stalled and seem unlikely to pass before the election is called.

## BANKING AND FINANCIAL SERVICES ROYAL COMMISSION

The Government released the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry on 4 February. Commissioner Hayne's report makes 76 recommendations, with a number that will impact directly and specifically on superannuation. These include:

- **Trustees' obligations:** the trustee of a registrable superannuation entity (RSE) should only perform that one role or office — it should not assume any obligations other than those arising from or in the course of its performance of its duties as fund trustee. Deduction of any advice fees—other than for intra-fund advice—should be entirely prohibited from MySuper accounts and only permitted from other superannuation accounts where specific requirements are met
- **Nominating default funds:** a person should have only one default account. Machinery should be developed for 'stapling' a person to a single default account. There should be no treating of employers. Trustees (and associates) should be prohibited from doing certain specified acts that may reasonably be understood to have a substantial purpose of influencing a person to nominate the fund as a default fund or to have their employees agree to become members of the fund
- **Regulation:** breach of the trustees' and directors' covenants and certain obligations in relation to MySuper should be enforceable by action for civil penalty. The co-regulatory roles of APRA and ASIC in relation to superannuation should be adjusted to reflect that APRA is the prudential regulator for superannuation and ASIC's role as the conduct and disclosure regulator primarily concerns the relationship between RSE licensees and individual consumers. The Banking Executives Accountability Regime should be extended to RSE licensees. The unsolicited offer or sale ('hawking') of superannuation to retail clients should be prohibited.

The Commission's report also includes a range of other recommendations in relation to the regulators, insurance and financial advice that have the potential to impact superannuation. These include:

- **Culture, governance and remuneration** — the Commission has recommended steps that all financial services entities should take to assess and monitor their culture and governance and address any issues that have been identified. It has also outlined actions APRA should take when conducting its prudential supervision of APRA-regulated institutions and revising its prudential standards and guidance, to focus more directly on culture and mitigating the risk of misconduct. Additional recommendations focus on how APRA should conduct prudential supervision of remuneration systems and revise its prudential standards and guidance about remuneration
- **Regulators** — the 'twin peaks' model of financial regulation should be retained but the roles of ASIC and APRA should be adjusted in relation to superannuation and ASIC should strengthen its approach to enforcement. There should also be key governance-related changes for the regulators, including capability reviews (at least every four years and commencing with APRA as soon as practicable) and a new oversight authority for APRA and ASIC. Recommendations of the ASIC Enforcement Review Taskforce relating to self-reporting of contraventions by financial services licensees should be implemented (these include changes to the 'significance test' for breach reporting)
- **A compensation scheme of last resort** should be implemented, as recommended in December 2017 by Professor Ramsay's review of the financial system external dispute resolution framework
- **Insurance in superannuation:** there should be close consideration of legislating universal key definitions, terms and exclusions for default MySuper group life policies. APRA's prudential standards should provide for additional scrutiny of related party insurer engagements and a greater focus on ensuring the rules by which a particular status is attributed to a member in connection with insurance are fair and reasonable. Key provisions in the Insurance in Superannuation Voluntary Code should be enforceable by ASIC.
- **Financial advice:** The law should be amended to provide that ongoing fee arrangements must be renewed annually by the client, must detail the services the client will be entitled to receive and the total fees to be charged, and must only permit the deduction of fees from an account with the client's express written authority. Disclosure should be strengthened in situations where an adviser does not meet the statutory concepts of 'independent', 'impartial' and 'unbiased'. The Government should review, by the end of 2022, the effectiveness of measures implemented by the Government, regulators and financial services entities to improve the quality of financial advice. Grandfathering provisions for conflicted remuneration should be repealed as soon as is reasonably practicable.

The **Government's** initial response to the report, *Restoring trust in Australia's financial system*, briefly outlined its intent to take action in relation to all recommendations made by the Commission. The Government has subsequently released further details of its proposed response to particular recommendations, and has proceeded to implement some of those actions. In particular, the Government has:

- Introduced amendments to the *Superannuation Industry (Supervision) Act 1993* (SIS Act) to ensure that breach of a trustee or trustee director's covenants or obligations would be enforceable by action for civil penalty and to prohibit trustees from 'treating' employers (see discussion below in relation to the 'Member Outcomes Bill')
- confirmed the details for capability review of APRA to be undertaken in the first half of 2019.

The Government has also announced it has given a direction extending the remit of the Australian Financial Complaints Authority's (AFCA). This will require AFCA to consider financial complaints dating back to 1 January 2008 (the start of the timeframe considered by the Royal Commission) that have not previously been heard and which fall within AFCA's current monetary limits and compensation thresholds. The Government will also strengthen regulatory oversight and transparency of remediation activities through increasing the role of AFCA in the establishment and public reporting of firm remediation activities. The Government's proposals in relation to AFCA are more expansive than the recommendations made by the Commissioner.

The **Opposition** has also announced a more extensive compensation scheme and more expansive powers for AFCA than those strictly recommended by the Commission. The initial response from the **Opposition** confirmed its in-principle support for each of the Commission's recommendations, and released a more detailed outline of its proposed actions on 22 February.

It is anticipated that the response to the Royal Commission will continue to feature heavily in pre-election policy announcements from both the Government and the Opposition.

**APRA** has indicated its commitment to expeditiously implementing the recommendations relating to its prudential and supervisory framework. Many of these will be addressed during 2019 and 2020, flowing from APRA's current post-implementation review of the prudential and reporting standards, while others will require legislative amendment.

**ASIC** has outlined its proposed response to the 12 Royal Commission recommendations that are directed at ASIC, or where the Government's response requires action by ASIC, without the need for legislative change. The action to be taken by ASIC includes:

- working with industry in anticipation of the Parliament legislating reforms in relation to codes—including the Insurance in Superannuation Voluntary Code—and ASIC's powers to provide for 'enforceable code provisions'
- monitoring and reporting on the extent to which product issuers are acting to end the grandfathering of conflicted remuneration
- continuing to implement its commitment toward a stronger enforcement policy, including a 'why not litigate?' stance, and creating a separate Office of Enforcement within ASIC during 2019.

## SUPERANNUATION REFORMS — PROGRESS OF BILLS

Parliament concluded its current sitting on 21 February and is not scheduled to sit again until 2 April, the date of the Federal Budget. While progress was made on some important reforms during February, a long list of superannuation bills remains before Parliament. The future of these bills will depend on how quickly the Government moves to prorogue Parliament and call the election after the Budget is handed down.

### *'PROTECTING YOUR SUPER PACKAGE' AND 'PUTTING MEMBERS' INTERESTS FIRST'*

The Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018 ("PYS Bill") has now been passed by Parliament with significant amendments. The Bill seeks to implement the Government's 'protecting your super' reforms, by modifying the circumstances in which insurance can be offered to members, imposing caps and a prohibition on the charging of certain fees, and expanding the circumstances in which inactive, low-balance accounts must be transferred to the ATO for consolidation. These reforms were announced by the Government in its May 2018 Budget.

The PYS Bill passed through the Senate in mid-February, with detailed amendments made by the Greens in agreement with the Government and later accepted by the House of Representatives.

In particular, the amendments:

- remove from the Bill provisions which would have made insurance opt-in for members under age 25 and for low-balance accounts (provisions effectively requiring members with inactive accounts to opt-in for insurance remain)
- extend the period of inactivity for an 'inactive account' and an 'inactive low-balance account' from 13 months to 16 months and prescribe a list of member actions that will mean the account is taken not to be an inactive low-balance account
- require the ATO to pay inactive account balances transferred to it under the new rules to an active account for the member, where satisfied it is possible to do so, within 28 days.

There were no amendments to the provisions in the Bill that impose a cap on administration and investment fees charged to members and prohibit the charging of exit fees. The commencement date for the PYS measures remains at 1 July 2019

On 22 February, Treasury released a draft of regulations to implement the reforms in the PYS Bill, with submissions closing 1 March. The draft regulations address the details of certain notices that trustees must give to impacted members, administration of the fee cap, and how the ATO will determine which fund a member's low-balance account should be consolidated into, where the member has more than one active fund.

On 20 February the Government introduced into Parliament the Treasury Laws Amendment (Putting Members' Interests First) Bill 2019 ("PMIF Bill"), to progress the insurance reforms that were removed from the PYS Bill by the Senate.

The PMIF Bill includes amendments that prevent trustees from providing insurance on an opt-out basis to members who are under 25 years old and begin to hold a new choice or MySuper product on or after 1 October 2019, and to members who hold products with balances below $6,000. In all circumstances, the member may opt-in to insurance by making a direction to the trustee. The new measure builds on reforms implemented by the PYS Bill.

The explanatory material indicates that, generally a person who is under 25 years old and who began to hold a MySuper product or choice product before 1 October 2019 will not be impacted unless the product had, as at 1 July 2019, been inactive for 16 months or the balance of the product had not been more than $6,000 since that date. However, the measure will apply to members who hold a product on 1 October 2019 which has not had a balance of $6,000 or more since 1 July 2019. The amendments impose obligations on trustees to notify members who have insurance arrangements in place before 1 October 2019 and who might be affected by the new measure to provide these members with an opportunity to elect for their insurance to continue.

The PMIF Bill remains before the House of Representatives, awaiting debate.

## MEMBER OUTCOMES

*The Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Bill 2017* ('Member Outcomes Bill') has been passed by the Senate with significant amendments, and now awaits consideration by the House of Representatives. The Bill proposes a wide range of reforms intended to enhance trustee accountability.

The Member Outcomes Bill was passed by the Senate in mid-February, with detailed amendments made by the Government, Opposition and Greens. The key amendments made in the Senate:

- impose civil and criminal penalties for contravention of the trustee and directors' covenants in sections 52 and 52A of the SIS Act occurring from the day after the Bill receives royal assent. These amendments represent part of the Government's response to the Royal Commission
- apply new criminal and civil penalties for breach of an expanded prohibition on 'treating' or 'incentivising' employers. Penalties will be imposed on trustees who use goods or services to influence employers to nominate the fund as their default fund, or influence employers to encourage their employees to nominate the fund as their chosen fund, where the contravention occurs from the day after the Bill receives royal assent. These amendments represent part of the Government's response to the Royal Commission
- completely rewrite the annual outcomes assessment for superannuation products so it applies to both MySuper and choice products, with relevant 'benchmarks' and 'comparable choice products' to be specified in regulations. The outcomes assessment measure will continue to apply from the day after the Bill receives royal assent
- modify the portfolio holdings disclosure regime, to require trustees to 'look through' pooled superannuation trusts, clarify the disclosure obligation to ensure it applies equally in respect of all MySuper and choice products, and defer the first reporting date to 31 December 2019 (rather than 2018).
- The Bill, which was initiated in the Senate, now awaits consideration by the House of Representatives.

## OTHER BILLS

In addition to the PYS Bill, several more bills relevant to superannuation were passed by Parliament during February:

- ***Treasury Laws Amendment (2018 Measures No 4) Bill 2018*** - this Bill makes a number of amendments in relation to superannuation guarantee compliance and penalties, single touch payroll (extension to small employers from 1 July 2019), fund reporting, employee commencement, Superannuation Complaints Tribunal secrecy provisions, and the taxation treatment of deferred annuities and reversionary transition to retirement income streams.
- ***Social Services and Other Legislation Amendment (Supporting Retirement Incomes) Bill 2018*** - this Bill implements changes announced in the Government's May 2018 Budget, including new means testing rules to encourage the development and take-up of lifetime retirement income stream products.
- ***Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018*** – this Bill the Senate l proposes a number of reforms to the penalties for certain criminal offences in ASIC-administered legislation, introduces new offences and significantly increases the penalties for others. The Bill, which implements some of the recommendations of the ASIC Enforcement Review Taskforce, was substantially amended by the Senate.
- ***Treasury Laws Amendment (Enhancing Whistleblower***

*Protections) Bill 2017* – this Bill amends the various whistleblower protections so a single, strengthened whistleblower protection regime covers the corporate, financial and credit sectors – including superannuation funds. It also inserts a comprehensive regime into the tax legislation for the protection of individuals who report breaches of the tax laws or misconduct.

A number of other relevant bills remain before Parliament – some were recently introduced while others have been on the legislative program for some time:

- ***Treasury Laws Amendment (2019 Measures No. 1) Bill 2019*** – this Bill was introduced into the house of Representatives during February and is yet to be debated. It includes amendments to the First Home Super Saver Scheme to bring forward the time that an individual can enter into a contract to purchase or construct their first home under the scheme. It also increases the maximum number of members for a self-managed superannuation fund or small APRA fund from four to six.
- ***Treasury Laws Amendment (Consumer Data Right) Bill 2019*** – this Bill was introduced into the house of Representatives during February and is yet to be debated. The Consumer Data Right (CDR) is intended to provide individuals and businesses with a right to efficiently and conveniently access specified data in relation to them held by businesses, and will authorise secure access to this data by trusted and accredited third parties. The CDR will require businesses in designated industry sectors to provide public access to information on specified products they have on offer. The CDR will initially to banking ('open banking') and the energy sector, however the Productivity Commission recently recommended that it be extended to superannuation.
- ***Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 2) Bill 2017*** – this Bill amends the superannuation guarantee (SG) law to provide that employees under workplace determinations or enterprise agreements made on or after 1 July 2018 have the right to choose their superannuation fund. It also provides that salary sacrificed amounts will not reduce an employer's mandated superannuation guarantee contributions. The Bill remains before the Senate.
- ***Treasury Laws Amendment (2018 Superannuation Measures No 1) Bill 2018*** - this Bill provides a one-off 12-month amnesty for unpaid superannuation guarantee (SG), allows a partial opt-out from SG for higher income earners with multiple employers, and makes integrity measures to support the 2016-17 Budget reforms. The Bill remains before the Senate.
- ***Treasury Laws Amendment (2019 Measures No. 1) Bill 2019*** – this Bill makes minor amendments to the First Home Super Saver Scheme, increases the maximum number of members for a self-managed superannuation fund or small APRA fund from four to six, and repeals redundant rules that related to the transition of funds to the Superannuation Industry (Supervision) Act 1993. The Bill was introduced into the house of Representatives during February and is yet to be debated.
- ***Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018*** – this Bill seeks to impose design and distribution obligations on issuers of financial products and provide ASIC with a product intervention power. The Bill remains before the House of Representatives.
- ***Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017*** – this Bill introduces a requirement that superannuation trustees have at least one third independent directors. The Government placed debate on this Bill on hold in the Senate and it is yet to come before the House of Representatives.
- ***Superannuation Objective Bill 2016*** – this Bill seeks to legislate primary and subsidiary objectives for the superannuation system. The Bill was passed by the House of Representatives in November 2016 but has not been debated by the Senate.
- ***Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018*** – this Bill proposes amendments to the Corporations Act 2001 to deter behaviours that prevent, avoid or significantly reduce the recovery of employment entitlements–including superannuation contributions–in insolvency. The Bill has been passed by the House of Representatives but has not been debated by the Senate.
- ***Treasury Laws Amendment (2018 Measures No 2) Bill 2018*** - this Bill creates the framework for an enhanced 'regulatory sandbox' to support innovation in financial services. The Bill has been passed by the House of Representatives but has not been debated by the Senate. SF

# Independent supervision

Super fund trustees need processes in place that guarantee members' best interests. **MAXIMILIAN ZIELINSKI** says that operational safeguards are required to ensure the oversight function is fully independent and that conflicts of interest are removed. One solution might be to follow the Swiss financial industry model and its use of 'investment controlling' services.

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry has revealed a broad range of structural problems within the Australian superannuation industry and raised questions as to whether super funds have been suitably concerned with members' best interests.

What's clear, from the final report, is that Kenneth Hayne isn't layering more regulations, but focusing on the practice of governance and getting trustees more focused on consequences. This is especially apparent in the introduction of a civil penalty for breach of the best interest covenant. The question remains how to implement the standard and how to make the system more transparent and accountable?

## GOVERNANCE AND OVERSIGHT

One of the problems that the Royal Commission has revealed relates to governance and oversight, and more specifically, the separation of powers between management teams and trustees.

A fund's management team—which will report to the board of trustees—is tasked with running the fund on a day-to-day basis, and is also responsible for the profitability of the entity. In contrast, the board of trustees is responsible for ensuring that the fund acts prudently, responsibly and honestly, complies with the trust deed and all legal requirements, and that it is run in the best interests of fund members. From a corporate governance point of view, a clear separation of powers between the management team and its trustees is crucial, due to the unique role that each party plays in the operation of the fund. However, trustee boards are often actually heavily reliant on management information—which can be conflicted—simply because boards can be quite diverse and contain individuals from a broad range of backgrounds.

As much as the independence of the trustee board is a critical part of good governance and an important safety-net, there is a certain degree of information asymmetry that exists between management teams and trustees, and this creates a problem. It's management that has an information advantage over the trustees and controls the flow of information, yet it's also management that is responsible for ensuring that the fund generates a profit. Trustees, however talented, high-achieving and of strong moral fibre and integrity in their professional careers and community contributions, unfortunately sometimes simply lack the requisite information to make the right decisions. They need to be better equipped.

## TRUSTEE ACCOUNTABILITY

Given the findings of the Royal Commission, the responsibilities of trustees are likely to be scrutinised more closely going forward. Regulators are likely to place a much greater focus on trustees' duties, and examine in detail whether members' best interests have been prioritised.

Trustee accountability is another issue that has come to the fore with the introduction of civil penalties for fund trustees that have failed to act in members' best interests.

It's worth pointing out that in Switzerland, the Swiss Federal Supreme Court recently found that the trustee board of a pension fund had violated its basic duty of ensuring the security of its assets. This was after the pension fund took excessive risks by significantly increasing its exposure to equities without building up adequate reserves beforehand. The supreme court ruling found that trustee board members were liable for the losses suffered by fund members, which illustrates how important it is for governing bodies of retirement funds to operate prudently.

As such, looking ahead, super fund trustees need to put processes in place that guarantee members' best interests take precedence. Operational safeguards are required in order to ensure that the oversight function is fully independent and that conflicts of interest are eradicated.

Regardless of how board of trustee members are chosen, in order to effectively fulfil their responsibilities, they must be able to exercise informed, objective and independent judgement, acting as a representative of all super fund members. Ultimately, trustees need a system that enables them to show that they are making the best possible decisions on behalf of super fund members.

## INDEPENDENT GOVERNANCE REPORTING

One solution in this respect is to follow the lead of the Swiss financial industry— which is known for its sophisticated financial regulatory framework—and its use of 'investment controlling' services.

Investment controlling seeks to provide independent supervision of the investment process and monitoring of investment assets, lending more visibility, transparency and credibility to the investment management process. Encompassing a broad range of investment support activities including governance advisory services, investment reporting, compliance and fee checks, risk management, portfolio analysis, and performance monitoring, its ultimate objective is to ensure that the decision makers receive independent management-relevant information.

In Switzerland, pension funds rely on investment controlling firms to monitor their investments, detect risks, and provide overall guidance with no conflicts of interest. By working independently of management teams and investment managers, investment controlling experts can ensure a neutral and objective oversight process that ensures clients' best interests are the top priority.

One of the major benefits of investment controlling—particularly from a trustee's perspective—is that complex financial information is summarised in clear, concise reports. Unlike most management reports, which are often both complex and protracted, investment controlling reports are straightforward and succinct, providing a clear investment dashboard which highlights the most important issues. This can empower trustees and minimise information asymmetry.

Note that in Switzerland, a Swiss Federal Supreme Court ruling states that trustees must fulfil their due diligence obligations in every respect from the first day of the actual assumption of the mandate. In other words, the liability of the board of trustees is not subject to any waiting period. The ruling says that trustees should obtain a "sufficiently comprehensive picture of the institution even before taking office" and that important issues such as risk management should be assessed before the acceptance of the mandate. Clearly, investment controlling services could be helpful in bringing trustees up to speed in this respect.

Given concerns over the influence of management teams on trustees, another investment controlling function that could benefit Australian superannuation fund trustees is that of unbiased consultancy services. Unlike asset consultants, investment controllers do not generate investment ideas nor do they advise on financial products; the sole objective is to provide independent third-party oversight of the investment management process. This expert advice and guidance from third-party investment professionals—completely independent and free of conflicts of interest—could be extremely beneficial to superannuation funds, as it could potentially help trustees make better decisions.

By providing appropriate information and data in a concise format to governing bodies of superannuation funds, along with proactive and incisive recommendations, investment controlling could add another layer of security for trustees, and help ensure that members' funds are being managed in their best interests.

## EMPOWERED TO MAKE THE BEST DECISIONS

The Australian superannuation industry looks set to undergo radical changes in the near future as a result of the findings of the Royal Commission. Going forward, there is likely to be a close focus on trustees and their accountability. With penalties potentially on the line for trustees that fail to act prudently, trustees need to be better equipped to make optimal decisions on behalf of members, and be able to show that they have proper systems in place that protect members' benefits at all times.

Given its independent nature, investment controlling or governance is one area that could certainly add value for the superannuation industry. It's not a 'magic bullet', as trustees are responsible for a number of different duties. However, with its focus on providing unbiased, objective advice, and summarising complex financial information into clear and concise reports, investment controlling could help ensure that trustees are empowered to make the best possible decisions and that members are the top priority. SF

Maximilian Zielinski is managing director APAC at LMM Investment Governance

# State of **Super**

**In this two-part series, set against the backdrop of the Royal Commission, Productivity Commission, regulatory changes and *Protecting Your Super Package* Bill, *SUPERFUNDS* spoke to some leaders who shared their perspectives on the current state of superannuation, some lessons learned and the outlook ahead.**


State of Super

# David Atkin – CEO, Cbus

**Q: How would you sum up the current 'state of super' in Australia?**
**A:** The truth is the Australian system is one we should be proud of. It is the one of the envies of the world. There's a very strong history of performance and connection with our members, and so there's strong levels of connection and satisfaction. But we're going to need to continue to adapt and improve because our members as consumers are changing and their expectations are changing. The weight of money also means the role of super funds in the economy has now become well understood. There are heightened expectations about our responsibility as investors and in our opinion that's an important area of consideration for us.

**Q: What do you see as some of the challenges ahead?**
**A:** The system doesn't need a fundamental overhaul. It's important therefore we don't throw the baby out with the bathwater. We do need to deal with the real problem of multiple accounts. There does need to be some sort of mechanism which enables automatic rollover. There does need to be a genuine end to conflicted remuneration. That was very much identified by the Royal Commission. There does need to be action on self-managed funds (SMSFs) which we think is the next area that really requires a response from government. It's clear to us the role of accountants advising around retirement is often to their benefit and not necessarily to their clients. And it's really important that funds can continue to tailor their offerings to specific demographics or industries. That's one of the real strengths of the Australian system.

**Q: How has corporate culture been impacted?**
**A:** Corporate Australia has been put on notice particularly by the Royal Commission. It's up to the justice system, government and shareholders, which includes us, to make sure this moment isn't lost. The Royal Commission has shown banks have attempted to squeeze short-term profit through scandals. Shareholders need to be more assertive in sending the signal into banks that we're not interested in short-term profits but value creation over the long term.

**Q: How can trust be rebuilt?**
**A:** The corporates, particularly the financial services sector, need to make sure they are making decisions that are in their customers' interest, as well as shareholders. They also need to think about being in business, not just next year, but the next ten years. I'd also like to see the financial services sector be more representative of the Australian community. Frankly, it's not diverse enough.

**Q: If I asked you question 1 in five years' time, how do you think the superannuation landscape will look?**
**A:** We will have provided better services and more tailored responses to our members. We will know who members are and have systems and technology in place to be proactive in tailoring interventions into members' lives.
At the macro level, the role of super funds in providing capital into the economy will become even more pronounced and even more important. There is the opportunity for the superannuation industry to reward long-term sustainable thinking that meets our community's desire to live in a world worthwhile living in.

# State of Super

# **Glen Hipwood** – Executive General Manager, Strategy and Performance at QSuper

**Q: How would you sum up the current 'state of super' in Australia?**
**A:** I've always been optimistic about the role the industry has played improving the retirement outcomes of our members and now that focus on the objective of the system has never been sharper. There are a few defining issues. In particular, the transformation of the industry over the next three years, as a result of the Productivity Commission and Royal Commission recommendations, as well as legislation before Parliament. Those changes will take a lot of time and energy from the industry. But we can't lose focus on delivering stronger member outcomes, particularly strong risk-adjusted returns as we navigate those changes. We also must ensure the industry maintains collective support of key areas that benefit members. That includes dealing with the unintended creation and maintaining of multiple accounts, meaningful levels of insurances, and fee disclosure and transparency.

**Q: What do you see as some of the challenges ahead?**
**A:** Balancing compliance with ongoing strong performance, as we look to implement the governance changes recommended. We also need to improve the image of superannuation, including the related advice and insurance industries. Members do better if they engage so we need to encourage them to have confidence and trust in what we offer, particularly while there is so much attention on superannuation. We have an opportunity to set what 'good' and 'great' looks like. The product the members receive when they join the fund is just as important as the default option and default system. We need to encourage investments that are not 'one-size-fits-all' default. Are they appropriate for the future when we know more about the member through data and information? I think we need to keep lifting the bar and this is an opportunity to do that.

**Q: How has corporate culture been impacted?**
**A:** We're passionate that culture and purpose are key to every part of the business and our practices. Good culture translates to good service for our members. We're conscious that people who work in the industry have had their confidence dented. We need to recognise that the vast majority are driven by the purpose to act in the best interest of members and we would do well to recognise and support them.

**Q: How can trust be rebuilt?**
**A:** Pretty simply, through action. Living the purpose. Demonstrating it through our engagement and the practices of the industry. Having a consistent voice at the industry level. Many would say there is too much change in the rules given super is a long-term investment. Certainty is required to provide confidence and trust, and we as an industry must support that.

**Q: If I asked you question 1 in five years' time, how do you think the superannuation landscape will look?**
**A:** It's going to be a more consolidated industry. Hopefully with greater member engagement and members realising the value of a well-planned retirement to a fulfilling life. We talk about best interest, so an industry that is synonymous with that through providing tailored solutions and creating value for members.


State of Super


# **Michael Chaaya** – Partner and Head of Financial Services at Corrs Chambers Westgarth

**Q: How would you sum up the current 'state of super' in Australia?**
**A:** The superannuation industry, along with the broader financial services sector, has undergone significant attention and scrutiny in the past year and is set to undergo a significant shake-up. But it is worth noting that the recent developments in the superannuation industry are not all bad news: in fact, the Financial Services Royal Commission highlighted positive aspects in the industry, in addition to areas where improvements may be needed. So against this backdrop, the current 'state of the super industry' could be described as evidencing significant goodwill from superannuation funds and their members.  However, some parts of the industry are currently facing pressures to improve culture, increase accountability and to offer products that are in the "best interests" of their members.

**Q: What do you see as some of the challenges ahead?**
**A:** The Royal Commission's report has made a slew of recommendations for the superannuation industry, and both major parties have indicated early on that they support all the recommendations. The challenge is not only translating each of the recommendations into meaningful legislation, but making sure any legislative amendments do not conflict, or complicate, other regulatory changes such as those posed by the Superannuation Bill (Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018) or the recent Productivity Commission report into the superannuation industry. The Government needs to reconcile the various recommendations of these inquiries and to make changes that are effective. The history of financial services reform has shown that more laws are not always 'better' laws.

The superannuation industry itself must confront the possibility of further regulatory reform and invest the time, energy and resources necessary to respond to the reforms in an adequate fashion.

**Q: How has corporate culture been impacted?**
**A:** If one were to try to identify the overarching theme of Commissioner Haynes' report, it might be said to be corporate culture. The Commissioner places culture as a "root cause" of misconduct in the financial services industry, describing culture as something which can both drive misconduct and discourage it. Commissioner Hayne points out that until very recently, there has been scant overt attention given in Australia to the importance of culture, whether by entities or regulators, but that there are signs of change looking ahead.

If culture has not changed as a result of the Commission, superannuation funds (and the broader financial services industry) are certainly on notice that they need to better self-regulate. An effective entry point to bringing about cultural change is to assess the remuneration and governance structures because these structures show what an entity values and are an expression of culture. Improvements in these governance and remunerations systems should then reduce the risk of misconduct in the future.

**Q: How can trust be rebuilt?**
**A:** Some of the revelations from the Commission's hearings and submissions were stark, and at times, confronting. Customers will no doubt be expecting to see changes and an effort by the financial services industry to take on board the Commission's recommendations. The superannuation industry is in a position to rebuild trust, and to do so, in some cases will need to undertake board and leadership renewal, cultural remediation and a sharpened focus on the expectations of customers in light of the perceived shortcomings of the financial services industry.

**Q: If I asked you question 1 in five years' time, how do you think the superannuation landscape will look?**
**A:** The superannuation industry has undergone periods of regulatory change in the past and has demonstrated that it is a resilient industry. So, in five years' time, one would expect the industry to still be performing strongly, if the recent growth trajectory in the industry is anything to go by. Perhaps the biggest changes will be to the governance of the industry. The role of ASIC and APRA and the push to embolden these regulators was a central theme of the Commission's report. If these regulators are given better resources and greater regulatory armoury, as has been recommended, then we can expect to see stronger external governance oversight in the industry in the future.


State of Super

# **Ben Walsh** – CEO Mercer Australia and Pacific

**Q: How would you sum up the current 'state of super' in Australia?**
**A:** The state of the industry currently is very busy, and everyone is thinking proactively about what the future might look like. But if you get on the balcony and away from that day-to-day business, I see a great opportunity before us. We have a very good retirement savings system in Australia and it would be great if some of the recommendations from the Productivity and Royal Commissions are implemented, particularly around multiple accounts and underperforming funds.

**Q: What do you see as some of the challenges ahead?**
**A:** For some in the financial services sector the main challenge is clearly about rebuilding trust with members. For most, however, transitioning to the new environment, whatever that form ultimately proves to be, will require a period of adjustment. Hayne's final report from the Royal Commission has been quite nuanced in that regard.

**Q: How has corporate culture been impacted?**
**A:** Culture is a funny thing. You can feel its effects within an organisation but it's hard to get your arms around it. The APRA report into risk culture at the Commonwealth Bank really prompted many boards across all industries in Australia to put a magnifying glass to the culture of their organisations. It quite rightly has put pressure on organisations and their boards to ensure their houses are in order. Many organisations are emphasising a strong culture of speaking up, and are rolling out training and internal awareness campaigns to reinforce this, along with general expectations of behaviour and what is celebrated within an organisation.

**Q: How can trust be rebuilt?**
**A:** To start rebuilding trust, there needs to be a balanced tone from the top of organisations that clearly puts members at the centre. Gaining trust requires actions – purposeful and meaningful actions focused on making the lives of members and investors better and driving better outcomes for them. They also need KPIs within the organisation that are focused on customer service. These are all things that can help.

**Q: If I asked you question 1 in five years' time, how do you think the superannuation landscape will look?**
**A:** Five years from now, after the changes have taken effect, we will see a marked reduction in unwanted multiple accounts within the industry which has already started to take place. We will see fewer funds. We will see tighter regulatory scrutiny, oversight and action, and probably more accountability for senior executives and trustees. Should they be elected, Labor's policy on refundable franking credits will change people's strategy and that may mean some SMSFs will be better off in APRA regulated funds. Retirement income products are going to be a stronger focus for funds. And, there will be more advanced technology for members to enable them to take a more self-service approach to managing their retirement wealth.

# *Rapid* change

**While the full impact of the Royal Commission's final report is still being analysed, some funds may take a wait and see approach – holding course until there is more clarity on regulatory changes. However, by not focusing on transformation now, SHAUN MCKENNA says funds may find themselves a long way behind later. Here he looks at the top ten trends over the next 12 months.**

For Australia's superannuation funds in 2019 the need for change has never been more important given the rapid shifts in regulatory requirements, member needs and preferences, competition and technology. And now the need to restore public trust can also be added to that list.

With such a rapid pace of change, some funds may take a wait and see approach – holding course until there is more clarity on regulatory changes. However, funds that are not focused on transformation now will find themselves a long way behind later.

From the need to take a comprehensive look at digital strategy, addressing member outcomes and engagement, M&A pressure, cybersecurity issues, operating models (including BPO and SaaS), collaborations, and the need to address governance and accountability issues as well as review and implement new technologies, the key factors impacting super funds are immense. Following are the top areas likely to impact Australia's superannuation industry over the next 12 months.

### 1. A 'DIGITAL TO THE CORE' APPROACH

There is a growing move toward taking a more comprehensive 'digital to the core' approach to superannuation. This is the need for funds to digitise not just the front office, but, their operations and registries as well. This is a critical step because:

- member experience is more than the front end. The processes that underpin that experience must be optimised as well, and
- it will be impossible to fully leverage the many developments behind these trends without a digital to the core approach.

Think about this as you read through the developments and trends below. How will any fund manage these issues without a true end-to-end, digital to the core approach?

### 2. REGULATORY UNCERTAINTY

At present, there are few confirmed regulatory changes in the pipeline for superannuation funds, in sharp contrast to last year. However, the recently released Royal Commission final report, the Productivity Commission report and the Australian Taxation Office's MIG3 will undoubtedly usher in significant changes over the coming year for funds, insurers and advisers. Those changes will be significant, to be policed by more aggressive (and potentially more powerful) regulators.

### 3. MEMBER OUTCOMES

Improving member outcomes will no doubt remain the biggest game in town as funds grapple with regulatory demands (both new regulations and more forceful regulators), increasing member diversity and needs, member acquisition, retention and growth and the broader palette offered by technology.

Funds will need to manage a wide range of issues including:

- reducing fees
- a single default fund for all members
- offering more diverse products beyond the default (including responsible investing)
- making better use of member data and better targeted marketing and communications to improve member support and education
- improving operations to drive better member services
- insurance in superannuation

### 4. MEMBER ENGAGEMENT

Likewise, embracing digital to transform member engagement will continue to be a major priority for funds, particularly given the growing sophistication of 'plug and play' member portals. This also includes the ability to provide:

- personalised member portals that enable members to manage their super

- direct information and advice (including robo-advice) as a growing number of advisers leave the industry
- a consistent experience across whichever channel a member chooses, including mobile and, now, voice
- a quality experience with a single customer view that is available both directly to the member and to intermediaries.

At the same time, the growth of companies such as MyProsperity and Mint highlight two important trends. The first is the increasing opportunities that are made possible by Fintech and Insurtech partnerships. The second is the growing importance of aggregating data to deliver a whole of wealth picture for members and their advisers.

### 5. ACCELERATING M&A ACTIVITY

Growing pressure from both the market and the government will see an acceleration in mergers and acquisitions (M&A) activity. The market is driving the push for M&A as a growing number of smaller funds begin experiencing net outflows and the banks seek to divest their superannuation operations. At the same time, the Government is driving consolidation through its push for scale and improved member outcomes and a range of other recommended initiatives such as 'best in show' tables. At the most extreme level, the potential for 'nationalising' superannuation through the Future Fund is being discussed, although there is significant opposition to this idea. Another possibility would be the Australian Taxation Office, which has more information on members than any super fund.

Conversely, while there is a push for consolidation and funds with greater scale, the industry is also seeing the emergence of several targeted niche funds. These include funds such as Future Super (ethical investments), Verve Super (female investors) and Student Super (student investors).

This increase in M&A activity, together with the opportunities for collaboration mentioned elsewhere, mean that funds need to begin looking beyond themselves. They must increase their awareness of the industry and prioritise the ability to collaborate with, or acquire and onboard, other companies.

### 6. CYBERSECURITY

According to a Deloitte report from November 2018, large pools of money and relative member disengagement (among other factors) make superannuation funds a potentially attractive target for cyber-attacks. The growing frequency and sophistication of cyber-attacks, the need to regain consumer confidence and the Australian Prudential Regulation Authority's recent CPS234 standard, will all significantly increase the emphasis on cybersecurity in the next 12 months. This, in turn, will become another reason for funds to explore new technology operating models (see below).

### 7. OPERATING MODELS

We will continue to see more funds exploring alternative operating models. This might include fully outsourcing their operations to a BPO provider or acquiring technology under a Software as a Service rather than purchase agreement. Or funds might opt for a hybrid model where, for example, back-office functions are outsourced, while member engagement is insourced. This growing interest in alternative operating models is being driven by two key factors. The first is the growing cost, disruption and risk associated with fully insourced operations given the rapidly changing needs, technologies and security issues (see above). The second is that outsourcing operations and/or technology can give the fund's leaders and trustees more time to focus on their members and core investment management business.

### 8. COLLABORATION

There is a growing push for funds to improve the effectiveness of third-party partnerships to drive member outcomes. This push exists on two levels. The first is the integration of systems and processes to ensure that the delivery of third-party products (like group insurance) are seamless, agile and efficient. The second is the creation of collaborative ecosystems that extend superannuation into whole of-life services and relationships (such as healthcare, health insurance, other financial products and, of course, retirement). This has the potential to dramatically increase the value funds can deliver to (and generate from) members over their entire lives. It also extends fund relevance to both retirees and younger members. In particular, the development of new retirement products and annuities will be a growing priority for funds, driven by the Government's Retirement Income Framework. As part of this Framework, means test rules for new products will come into effect on 1 July 2019, with funds required to have a retirement income strategy by mid-2020 and Comprehensive Income Products for Retirement by 2022.

This will impact funds in several different ways, including:

- partnerships with aged care and assisted living providers, annuities and other CIPR product providers (who are already entering the market)
- product configuration capabilities
- the extension of member relationships and engagement into retirement

## 9. GOVERNANCE AND ACCOUNTABILITY

There is currently a widespread call for both a revamp of fund boards and greater trustee accountability. This is being driven by a potential new accountability regime, the trust damage the sector has recently experienced, Productivity Commission recommendations to improve the expertise and diversity of boards, and calls from various groups for greater trustee accountability (such as the recent Institute of Public Accountants call for greater accountability in relation to retirement). The need for trustees to be fully informed about their fund's members, operations and compliance as well as the broader sector are now more important than ever. This will place greater pressure on the fund's analytic capabilities, performance management and reporting.

## 10. AUTOMATION, NEW TECHNOLOGIES AND PLATFORMS

The rapidly emerging fourth industrial revolution is having a profound impact on the way funds operate. It will lead to dramatic improvements in everything from data and knowledge management (cognitive analytics and quantum computing), processes (machine learning and robotic process automation) and member engagement (robo-advice and voice engagement).

While less progressive funds will see automation as a path to cost savings and nothing more, smarter funds will see automation as a way to drive efficiency AND member outcomes. They will pay careful attention to aligning their people and technology into intelligent operations.

The next 12 months will also see the implementation of the New Payments Platform, the first phase of Open Banking and the growing adoption of Blockchain. These, together with the increasing use of faster, less disruptive APIs will dramatically change the way both members and funds manage their super and other financial services. They will enable greater efficiencies, convenience and speed as well as higher levels of accuracy and trust.

There will also be challenges, of course. The initial rollout of open banking will require funds to be able to deliver data to other providers seamlessly. In the long term, however, when open banking extends beyond banks to superannuation, it could open up exciting new opportunities for funds to leverage their life-long relationships.

The ten trends above demonstrate just how fast and significant change has become in the superannuation sector. Some might say withering. Some might throw their hands up and call it too hard. Some might wait for a more ordered time to transform.

But the funds who are genuinely looking to build sustainability based on delighted members, partners, investors, collaborators and regulators will be busy transforming right now.SF

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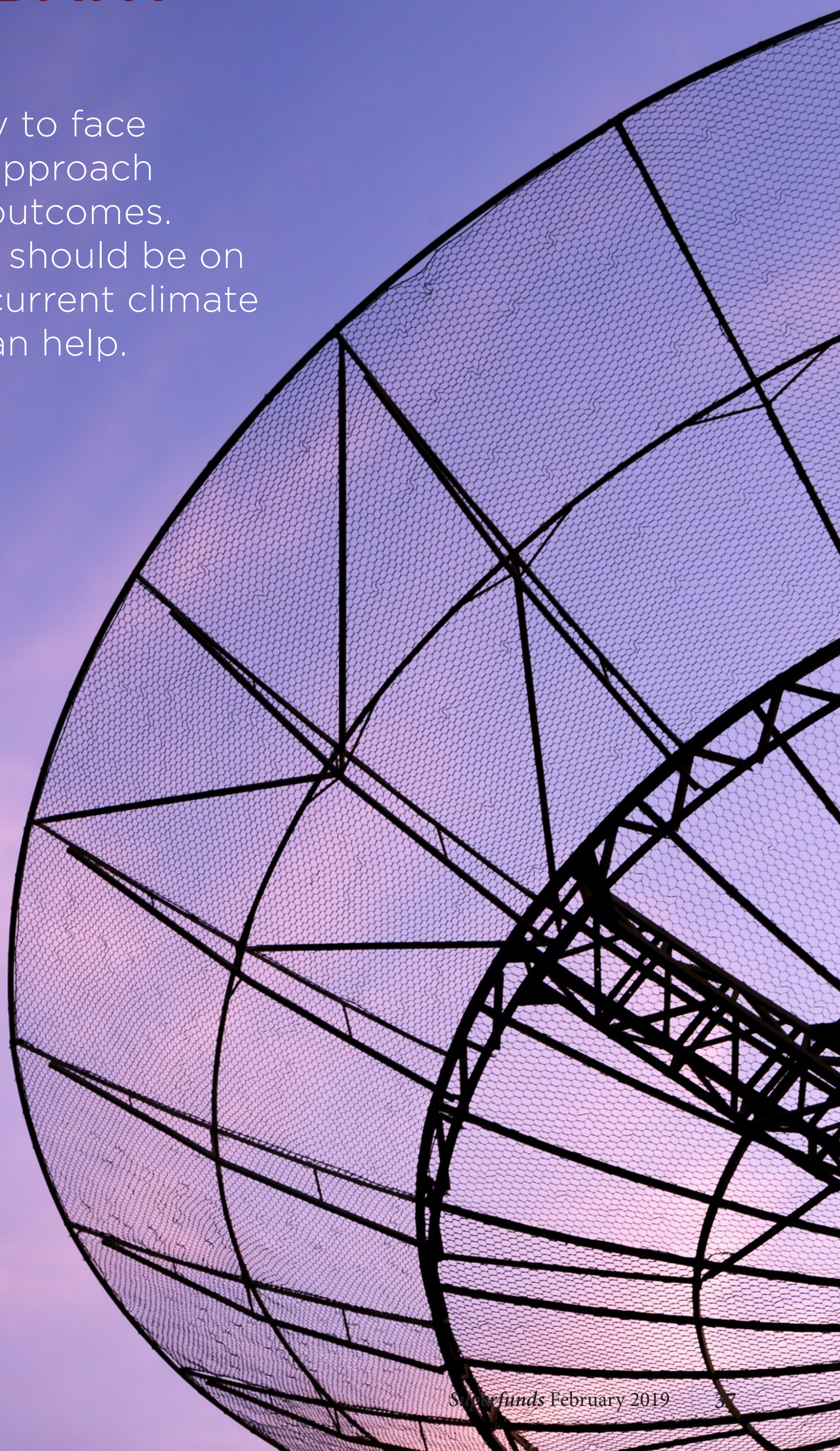
Shaun McKenna, is senior director of client relations at SS&C Australia

# MANAGING FOR AFTER-TAX RETURNS. IS IT ON YOUR RADAR?

Superannuation trustees are likely to face increasing scrutiny around their approach to tax and its effect on member outcomes. ***SUPERFUNDS*** highlights why tax should be on the radar of every trustee in the current climate and how after-tax benchmarks can help.



Tax considerations are set to become an even larger focus for trustees as they look to address key issues raised by the Royal Commission into Banking, Superannuation and Financial Services and the Productivity Commission into Superannuation.

A key area called into question by the Royal Commission was whether trustees were performing their duties in the best interests of members. From an investment governance perspective, trustees have a fiduciary obligation to take tax considerations into account as part of their investment strategy under APRA's prudential standard on investment governance (SPS530). Embracing tax considerations more fully would give trustees an opportunity to appease regulatory concern and maintain their fiduciary duties.

The Productivity Commission has also made it clear that it considers tax management to be an important aspect of looking after members' best interests, stating "Maximising net returns (after fees and taxes) is the most important way in which the superannuation system contributes to adequate and sustainable retirement outcomes". It did seek to review superannuation fund's after-tax investing practices but found it difficult to obtain related data. This suggests that the industry still has a way to go in relation to after-tax measurement and reporting

## THE IMPORTANCE OF HAVING AN AFTER-TAX FOCUS

The most important reason to manage for after-tax returns is that members receive their returns after tax.

Tax is also a significant cost that can have a major impact on returns. The extent of that impact can be seen by comparing returns of the FTSE ASFA Australia 300 - Superannuation Index (which takes tax into account) with the FTSE ASFA Australia 300 - Tax Exempt Index. As the last column in the table below shows, the impact of tax has ranged between 5 per cent and 44 per cent over the past 7 years. It is also interesting to note that the smaller the total return, the more significant the tax impact.

This simple example highlights that tax can, and does, have an impact on returns. Numerous studies into tax aware investing have also clearly demonstrated that value can be added to members' returns by taking tax considerations into account.

Trustees clearly have a huge opportunity to improve members' after-tax returns by giving tax due consideration as part of the investment process.

## AFTER-TAX MEASUREMENT AND BENCHMARKING

Given members receive after-tax returns, it makes sense for investment performance to be measured on an after-tax basis. However, not all superannuation funds measure after-tax returns.

A key obstacle impeding trustees' adoption of after-tax benchmarks is the widespread use of pre-tax indices as benchmarks, which is what superannuation funds have traditionally used to measure and assess fund managers.

This traditional method of benchmarking can create a misalignment between superannuation funds and their fund managers as some investment decisions, that are attractive on a pre-tax basis, may harm after-tax performance. For example, if a fund manager's performance is measured on a pre-tax basis, the fund manager has no incentive to wait those few extra days when selling the fund's shares to get a discount on the capital gain that the sale might have generated if the shares had been held for more than 12 months. Thus, capital gains tax may not be managed as efficiently as it could be. Likewise, when a fund manager is benchmarked to an index that does not contain franking credits, the fund manager might sell its holdings in a company before fulfilling the 45-day rule. Thus, the fund does not benefit from franking credits as part of the dividend distribution and the value of the franking credits is overlooked.

This misalignment is potentially hazardous from a governance perspective, so why haven't more superannuation funds adopted an after-tax benchmark? The ingrained use of pre-tax indices as benchmarks is one factor, but other factors include complexity and cost.

To help make the transition to after-tax performance measurement and reporting less complex and costly, FTSE and ASFA launched the first industry standard after-tax benchmark in 2009 – the FTSE ASFA Australia Index Series.

**Exhibit 1:** Return Attribution: FTSE ASFA Australia 300 - Superannuation Index vs. FTSE ASFA Australia 300 - Tax Exempt Index

| Tax Year Returns (%) | Price Return | Income Return | Franking Credits Contribution | Off-Market Buy-Back (Net of Tax) | Tax on Grossed Up Dividends (tax rate of 15%) | FTSE ASFA Australia 300 - Superannuation Total Return (I) | FTSE ASFA Australia 300 - Tax Exempt Total Return (II) | Difference in Total Return (I-II)/II |
|---|---|---|---|---|---|---|---|---|
| 2011-2012 | -11.6 | 4.5 | 1.5 | 0.0 | -0.9 | -6.5 | -5.6 | 17% |
| 2012-2013 | 15.8 | 5.5 | 1.9 | 0.0 | -1.1 | 22.1 | 23.2 | 5% |
| 2013-2014 | 12.0 | 5.1 | 1.8 | 0.0 | -1.1 | 17.8 | 18.9 | 6% |
| 2014-2015 | 0.8 | 4.6 | 1.6 | 0.0 | -1.0 | 6.1 | 7.0 | 14% |
| 2015-2016 | -4.2 | 4.7 | 1.6 | 0.0 | -1.0 | 1.3 | 2.2 | 44% |
| 2016-2017 | 9.2 | 4.8 | 1.6 | 0.0 | -1.0 | 14.6 | 15.6 | 6% |
| 2017-2018 | 8.4 | 4.8 | 1.7 | 0.0 | -1.0 | 13.9 | 14.9 | 7% |
| 2018-2019* | -9.0 | 2.1 | 0.7 | 0.2 | -0.4 | -6.4 | -6.0 | 8% |

*till 31/12/2018

***Source:*** *FTSE Russell, data as at 31 December 2018.*

## A CLEARER PICTURE FOR ALL INVESTORS

The FTSE ASFA Australia Indexes offer broad, investable coverage of the Australian Equity market in addition to tax-adjusted indices for superannuation funds and other types of Australian investors. It combines unique tax features with FTSE Russell's rules-based methodologies and global standards.

FTSE Russell uses varying tax rates to calculate a franking credit and buy-back adjusted versions of the FTSE ASFA Australia Indexes for tax exempt investors, superannuation funds, investors in the mid-tax bracket and investors in the high-tax bracket, as outlined in exhibit 2.

Superannuation funds can choose from a range of benchmarks that take the effects of franking credits into account. The standard index allows for franking credits to be reinvested on ex-dividend dates. As an alternative, investors can opt for accumulating franking credits on a daily basis and reinvesting those credits at the end of the financial year or on a specific date.

The importance of taking franking credits and income tax into the return calculation can be seen by looking at the performance of the FTSE ASFA Australia 300 Index, shown in exhibit 3.

The grey line represents the price return, which is around 50 per cent over a decade, at 4.1 per cent p.a. The blue line represents the price return plus dividends minus income tax, which is 150 per cent return over a decade, at 9.6 per cent p.a. The red line represents the price return plus dividends, which is 174 per cent return over a decade, at 10.6 per cent p.a. The main takeaway is that the annual total return is more than twice the size of the annual price return.

## A STEP IN THE RIGHT DIRECTION

Adopting an after-tax benchmark is a positive step towards improving after-tax returns because, as the old proverbs goes, 'you can't manage what you don't measure'.

That said, there is a lot to consider when it comes to maximising net returns, after fees and taxes, for members. By working closely with their fund managers, custodians and other stakeholders, trustees are taking a step closer to improving after-tax outcomes from members. SF

**Exhibit 2:** A clearer picture of performance for all types of investors

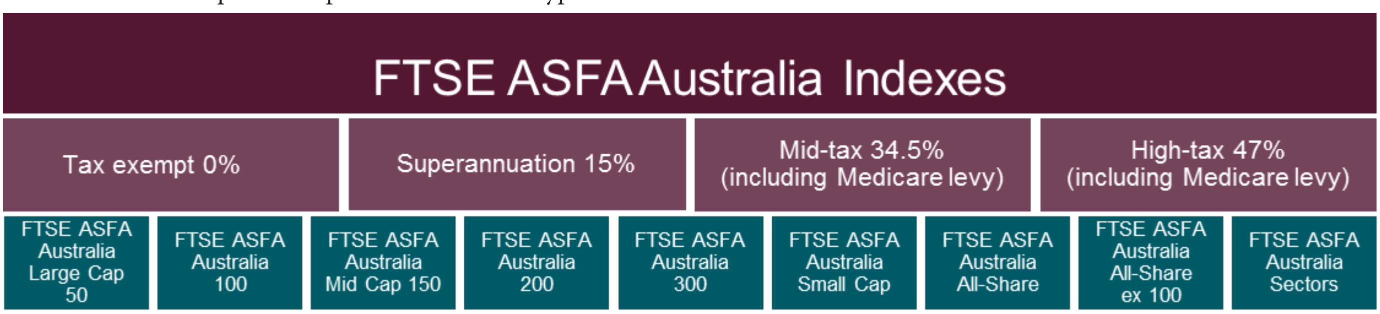
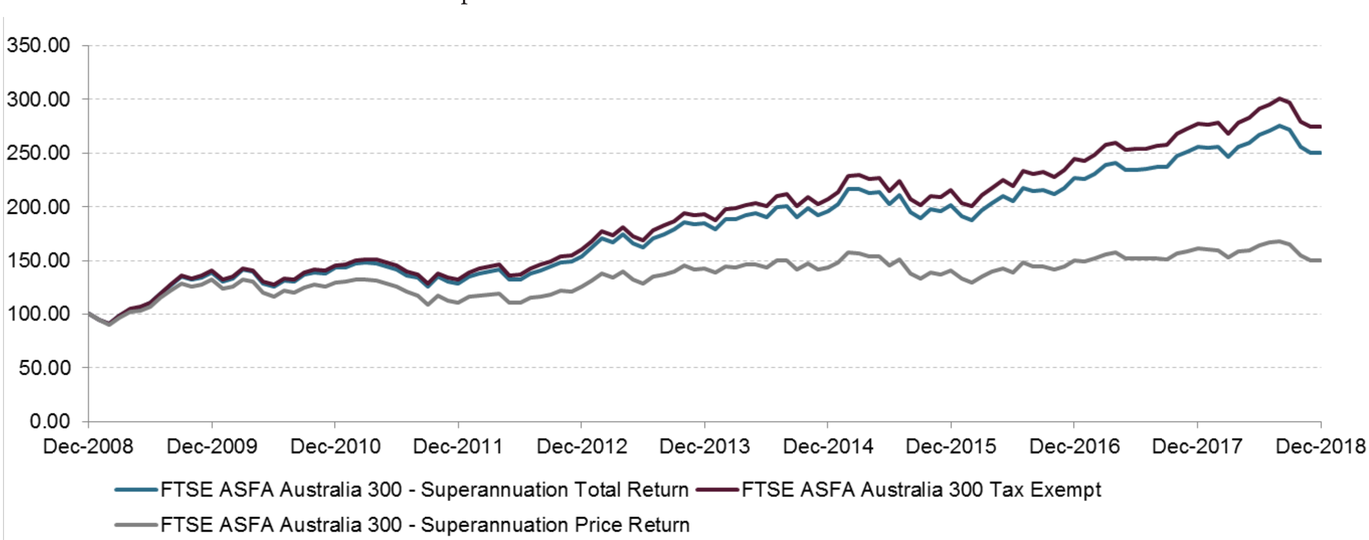



**Exhibit 3:** FTSE ASFA Australia 300 Index performance



# Collaborating for improved after-tax returns

Superannuation trustees have a huge opportunity to improve after-tax outcomes for their members by working closely with fund managers, custodians, and other stakeholders to fully understand the tax consequences of their investment strategies.

To help trustees down this path, PwC produced the paper in 2016 called 'Ten questions to ask your investment manager and custodian on tax'.

By asking these questions, which are briefly summarised below, trustees will be able to gain a better understanding of their fund manager's capabilities, as well as identify areas for improved interaction and collaboration.

Ten questions to ask your fund manager about tax:

**1. Do you have a strategy to maximise after-tax returns?**
Check whether the manager considers costs, such as capital gain tax liabilities, the loss of franking credits, or higher execution costs, as part of the decision to make a trade.

**2. What impact does your style of investing and portfolio turnover have on the fund's after-tax returns?**
Understanding the manager's style, and how it manages tax costs, allows trustees to assess the expected after-tax and after-fee outperformance.

**3. Does the custodian efficiently allocate tax parcels, and on what basis?**
The various approaches to selecting tax parcels, such as First In First Out (FIFO), impacts how the fund manager manages the timing around realised gains and losses.

**4. Do you consider tax implications before trading?**
In order to maximise after-tax returns, a fund manager needs to have a system in place to calculate tax impacts. This invariably requires information from the custodian, so it's good to know how a fund manager interacts with the custodian.

**5. Would you delay or bring forward an investment decision because of the tax implications?**
If the answer to this question is a resounding no, this may indicate that an after-tax performance measurement and benchmarking process should be implemented.

**6. Do you participate in off market buy-backs?**
Fund managers face a difficult choice when it comes to participating in off market buy-backs because it may be detrimental to their pre-tax performance published in surveys, and the benefit for investors depends on their individual tax rate. Generally speaking, it is beneficial for pension assets and other tax-exempt investors to participate in off market buy-backs.

**7. Do you manage the portfolio specifically for my tax status (individual, super, tax-exempt, pension)?**
If superannuation funds segregate pension and accumulation assets, investment mandates can be tailored and managers can be appointed to optimally manage the after-tax return for the underlying client.

**8. Is after-tax performance systematically measured?**
Funds should be asking their fund managers how they manage tax costs and whether they can demonstrate after-tax returns are being maximised. The easiest way to accomplish this is for funds to start measuring managers on an after-tax basis against an after-tax benchmark.

**9. Is the existing measurement of after-tax portfolio and benchmark returns conducted in a robust and meaningful methodology?**
A key issue in after-tax return calculations is whether the calculation is done on a pre-liquidation or a post liquidation basis.

**10. Can you operate under a Centralised Portfolio Management (CPM) approach?**
There are many issues to be carefully considered and analysed before adopting CPM, but super funds should consider the role they can play in tax efficiency when they are large enough to use individual mandates rather than unit trusts.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A full range of after-tax benchmarks designed for Australian superannuation funds. Franking credits, off-market buy-backs, capital gains tax and customised solutions, for a more precise measure of performance.
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# Delving into some technical insurance issues

MATT DALEY, JANE PASKIN AND VANESSA PALLONE OF CLAYTON UTZ

## CASE 1

*When can an insurance company avoid paying out a claim on the grounds the member has made a fraudulent misrepresentation when completing the application for the underwritten cover?*

The insurer's right to avoid the contract of insurance is found in section 29(2) of the Insurance Contracts Act 1984 (Cth) (ICA) and, in this case, the member complained to the Tribunal, lost that first decision and then appealed to the Federal Court. The Court found the Tribunal had erred in law and sent the matter back to the Tribunal for further consideration.

The member was unable to work due initially due to a major depressive disorder which then developed into schizophrenia. The first symptoms of depression probably commenced in 2006 and the first medical consultation was May 2007. In March 2007, the member applied for $1,080,000 total and permanent disablement cover. The written application included the following questions:

*"Have you ever had high blood pressure, heart or vascular disease, chest pain, rheumatic fever, stroke, diabetes, kidney, bladder, liver or bowel disease, asthma or any lung disease, blood disorder, epilepsy or fits, multiple sclerosis, tumour or cancer?" and*

*"Have you ever had any mental disorder, depression, stress, anxiety or chronic fatigue or any eye, ear or skin disorder?"*

The member answered 'no' to both of these questions. Interestingly, the application also contained a declaration which contained the following wording:

*"…I consent to my personal information (including health and sensitive information) being collected, used or disclosed by [Former Insurer] or its external service providers/contractors as contemplated in this form, including collecting it from or disclosing it to any medical practitioner or third party as required to assess, verify or process my application. This consent applies to any health and sensitive information [Former Insurer] collects on this form or future forms in relation to this insurance."*

In 2000 the member's wife died of an ectopic pregnancy and malpractice at the hospital that was treating her. This resulted in the member having to leave work to look after his young family. He also commenced legal proceedings in relation to his wife's death which included a nervous shock claim. At this time, he was an outpatient at a community mental health centre who assisted him in coping with his grief. He was prescribed medication for depression. Evidence was the depression settled and, in time, he returned to part-time work whereupon he became a member of the fund.

The insurer agreed to pay the automatic default cover but denied the underwritten cover on the grounds the member had not disclosed in his application the medication for depression he took after his wife's death. There was also medical evidence that the member had tachycardia and had been taking medication for that condition for some time.

The Tribunal had to consider the test for what amounts to a fraudulent misrepresentation. Here it quoted from Mann's Annotated Insurance Contracts Act 6th Edition at [29.20.2] that:

*"…It is well settled as to what constitutes a fraudulent misrepresentation. A statement is made fraudulently if it is made with knowledge of its falsity or without belief in its truth or recklessly, not caring whether it is true or false. This formulation, which dates back to Derry v Peek (1889) 14 App Cas 337 at 347 has been adopted in cases concerning s 29(2) …".*

The Tribunal also noted the decision of the NSW Court of Appeal in Dawes Underwriting Australia Pty Ltd v Roth [2009] NSWCA 152 where the Court found that the test to prove fraud is a "high hurdle but that is the nature of an allegation of fraud which involves a mental element not required in the case of carelessness or negligence".

The member's answering of the questions noted above in the negative underpinned the insurer's view that the member had made fraudulent misrepresentations entitling it to deny the claim. The Tribunal carefully analysed the precise wording of each question and relevantly noted that they grouped unrelated medical conditions together like 'heart disease' with 'liver or bowel disease' and this made it difficult for a prudent person seeking cover to respond accurately. The second question grouped 'depression' with an 'eye or skin disorder'. The questions themselves lacked both internal and external logic and were confusing.

The Tribunal also found that if a prudent person completing the application for cover was confused by the medical questions they would take comfort from reading in the declaration that "to the extent they might have carelessly omitted a relevant representation, the subsequent compulsory 'Medical Examination by own Doctor' – pursuant to an insurer provided 'medical examiner's report' as well as a 'resting ECG' would rectify any omissions". Further, the form made it clear that the insurance company was effectively being given 'carte blanche', from a legal perspective, to fully utilise its investigative powers. In these circumstances, while the Tribunal agreed the member had answered the relevant questions incorrectly, as he had consulted with medical or allied health professional for claimed medical conditions, he had also given an explanation as to why this had occurred. For example, he did not regard tachycardia as heart disease or feeling terribly sad after his wife's death as a mental disorder. In these circumstances, the high hurdle of fraudulent misrepresentation had not been made out. The necessary mental element was simply not there on the facts to make a finding of fraud.

The Tribunal substituted its own decision and effectively ordered the insurer to pay out the claim with interest in accordance with section 57 of the ICA.

**Case D18-19\086**

## CASE 2

*The insurance company refused to pay out under an income disability policy initially on the grounds the member's disability did not stop him coming back to work. Later they refused to pay on the grounds he did not have a valid "Well Control Certificate" which was compulsory paperwork under the terms of his employment.*

In February 2015 the member commenced employment on an offshore oil rig on a four weeks on four weeks off 'fly in fly out' basis. He was employed as a rig manager and tool pusher which involved supervising up to twenty people and working long days with some heavy lifting. In October 2015, he hurt his shoulder at home and this injury got progressively worse over time. He consulted a chiropractor but with his symptoms not improving he failed to return to his next shift in March 2016.

The insurer and, by extension, the trustee were essentially arguing the member had failed to satisfy the definition of 'temporary incapacity' contained in regulation 6.01 of the Superannuation Industry (Supervision) Regulations 1994 (Cth) (SIS Regulation). That definition requires the member to cease to work because of ill-health, whether physical or mental. The insurer argued that the member had ceased work due to the lack of necessary paperwork not his shoulder injury and, therefore, he did not satisfy the SIS Regulation.

The Tribunal held that the insurer's contentions were misconceived as the SIS Regulation is not an additional hurdle to satisfy over and above the hurdles in the policy. Rather, the starting point is to determine if under the policy terms the trustee (as owner of the policy) is entitled to payment. If the member's ill-health satisfies the policy terms, the insurer pays the trustee, who —knowing the member meets the SIS Regulation—can lawfully release the monthly benefit to the member.

The Tribunal then reviewed the medical evidence against the policy definition and concluded the shoulder injury fulfilled both the requirements of the definition in the policy and, by way of completeness, the definition of temporary incapacity in the SIS Regulation.

The Tribunal substituted its own decision for that of the insurer and trustee effectively requiring the payment to the member of the insured benefit together with interest in accordance with section 57 of the ICA.

**Case D18-19\088** SF

# **Counting** the costs

**Ross Clare**
Fellow of ASFA

ASFA Director
of Research

February 2019 was a big month for superannuation, with more pieces of superannuation related legislation passed than in the previous year or so (which was not a high benchmark).

There were also various big numbers bandied about in debates, Explanatory Memorandums and the like.

Everyone is in favour of evidence-based policy development, especially if evidence can be found to support a position based on belief or ideology. The bureaucrats who have to put together Regulation Impact Statements—which clearly demonstrate that a proposed measure is far superior to any other options—know all about this.

Individuals having more than one superannuation account, with associated additional administration charges, has been an issue receiving policy attention for a considerable period of time.

Estimates of the extent of this problem have been many and varied.

The data have improved over time with annual estimates published by the ATO. At least we no longer have claims (including by regulators who should have known better) that the average number of accounts per person is three (based on what used to be 30 million accounts in the system and around 10 million employees).

There are 15.6 million or so people with super, as account holders include the self-employed, retirees, the unemployed, people temporarily out of the labour force, and expatriates. Many of these latter accounts might be inactive but they certainly are not superfluous.

The notion of the average person also gets some statistical abuse by some commentators. The average Australian is not an amalgam of extremes. The average Australian, as in median or most Australians, has only one superannuation account. 85 per cent have either one or two accounts.

The largest part of the multiple accounts problem comes from the serial offenders, the six per cent or so of Australians who have four, five, six or even more superannuation accounts. Rather than being a function of being young and moving between casual jobs, the incidence of multiple accounts peaks for those in their 40s. Males are also more likely than females to have multiple accounts.

While individuals might have a second account because of objectively sound reasons such as insurance benefits, running a Transition to Retirement strategy, or having a defined benefit account that cannot be rolled over on a change of job. The number of such accounts might be around 5 million in total.

However, four or more accounts is hard to justify. In aggregate this group accounts for some 3.6 million of unnecessary, duplicate accounts. If you include unnecessary accounts held by people with three or more accounts that number goes up to around 6 million accounts.

Reducing the number of duplicate accounts in the system is a worthy objective but it is not something that will improve retirement outcomes for the average Australian. I am not sure that I would want to aspire to be an average Australian in any event.

Somewhat paradoxically, reducing the number of multiple accounts is likely to lead to higher fees for those with only one or two accounts, as fixed costs of funds are spread over fewer accounts. However, variable costs of course are reduced. Various organisations have already forecast declines in revenue received by them for administration services, with the amounts in tens or hundreds of millions of dollars a year.

Some of the other changes, while presented as being beneficial for the average fund member, are more about shifting the allocation of costs and fees rather than reducing the overall costs of the system. Overall costs are likely to increase from a number of recent changes due to increased complexity of compliance and administration. The latest incarnation of member protection is a case in point. While erosion of small account balances by fees is not conducive to inspiring confidence in superannuation, measures to avoid this necessarily lead to increased fees for others. The trust structure for superannuation means that in many cases the allocation of fees is a zero-sum game. Over a lifetime the total fees paid by an individual might not reduce much, or they may even increase.

Given the amount of changes recently legislated the superannuation sector has had a lot to digest and implement, with quite tight timetables in several cases. ASFA will be carefully monitoring developments and, where possible, obtaining clarification on requirements and regulator expectations regarding new and at times complex provisions. Indigestion should be avoided if possible. SF