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

Review into the governance, efficiency, structure and operation of Australia's Superannuation system (the Cooper review)

“ *We don't have a high level of transparency and I think it is quite important that if investors want to know what they have invested in they should be able to have access to it.* ”

Greg Medcraft, Chairman, ASIC

“ *In the 20 years from March 1991 to March 2011, superannuation assets grew from \$123 billion to \$1314 billion. These assets now represent a tremendous store of wealth upon which millions of Australians expect to draw to fund their retirement. But will these assets be there when they are most needed or does super have the characteristics of a Ponzi scheme...?* ”

Nick Birrell, Adjunct Professor and Founding Director of the Monash Asia Pacific Centre for Science and Wealth Creation, Monash University

“ *We talk about disclosure of the companies we invest in, but how many of us disclose our pay or what we are doing with our investment portfolios? We need to be more open.* ”

Danielle Press, CEO, Equisuper

“ *We need to investigate what people actually want to know – the starting point could be some basic consumer research to find out what investors want.* ”

John Brogden, Chief Executive, Financial Services Council

“ *In an industry where there are a lot of outsourcing arrangements and related party transactions it is very important to have the appropriate degree of rigour around the conduct and the transparency of funds.* ”

Ross Jones, Deputy Chairman, APRA

Executive summary

Australia's superannuation industry is built on compulsory contributions of a minimum of 9 per cent from the Australian workforce, with its \$1.34 trillion in assets making it one of the world's largest retirement savings schemes.

Recent instances of unsatisfactory performance and substantial failures of oversight in the superannuation industry have generated a strong community response and calls for policy revision. While the Australian Government is seeking to lift the compulsory superannuation guarantee from 9 per cent to 12 per cent, the pace and breadth of reform to ensure adequate and appropriate transparency and disclosure appears to be lagging.

CPA Australia's concern is that effective information is fundamental to improvement in the performance of Australia's compulsory savings policy and at this stage the level of commitment to reporting is not obvious.

In an industry that is essentially a collection of investment vehicles, a significant proportion of which is managed by the private sector, substantial questions have arisen over the overall adequacy of disclosure, especially when compared with the disclosures required of other investment vehicles.

Australia's compulsory superannuation policy effectively drives a high proportion of savings into private sector investment vehicles, many of which are elected by "default" through employment-based arrangements. The unique design of Australia's retirement savings system calls for a high level of accountability from those responsible for the management of the superannuation fund industry.

Issues arise from the lack of information available to investors who wish to understand the nature and performance of their fund manager, the portfolio choices, risk profile and personal alignment of managed fund products and the fees, salaries and other payments attributed to the various participants in the governance of these investment vehicles. Given the extent of concern reflected in various public inquiries and reviews, it is imperative that any step forward requires superannuation policy to adopt a high standard for the mandatory information provided to those who are compelled to invest in this way.

The goal of establishing equitable private savings for retirement is not in question, but it is clear that a number of fundamental issues have yet to be resolved. A sample of members' views obtained through a short member poll conducted by CPA Australia provides some indication of the deep reservations members have about the standards of disclosure that apply to superannuation fund offerings. More than 75 per cent of respondents believed there was a lack of transparency about costs and underlying asset investments of superannuation funds, and that reporting should be of the same standard as listed entities. The poll also found that approximately 90 per cent of respondents believed that there should be more transparency around trustee remuneration, senior executive remuneration and management fees paid to advisers.

In the next 12 months CPA Australia will undertake a research initiative to crystallise these initial concerns into tangible outcomes and policy initiatives. This issues paper launches CPA Australia's research initiative by highlighting some facts and perceptions surrounding transparency in Australia's superannuation industry.

“My gripe isn't so much with the costs, but the complete lack of communication.”

CPA Australia poll respondent comments

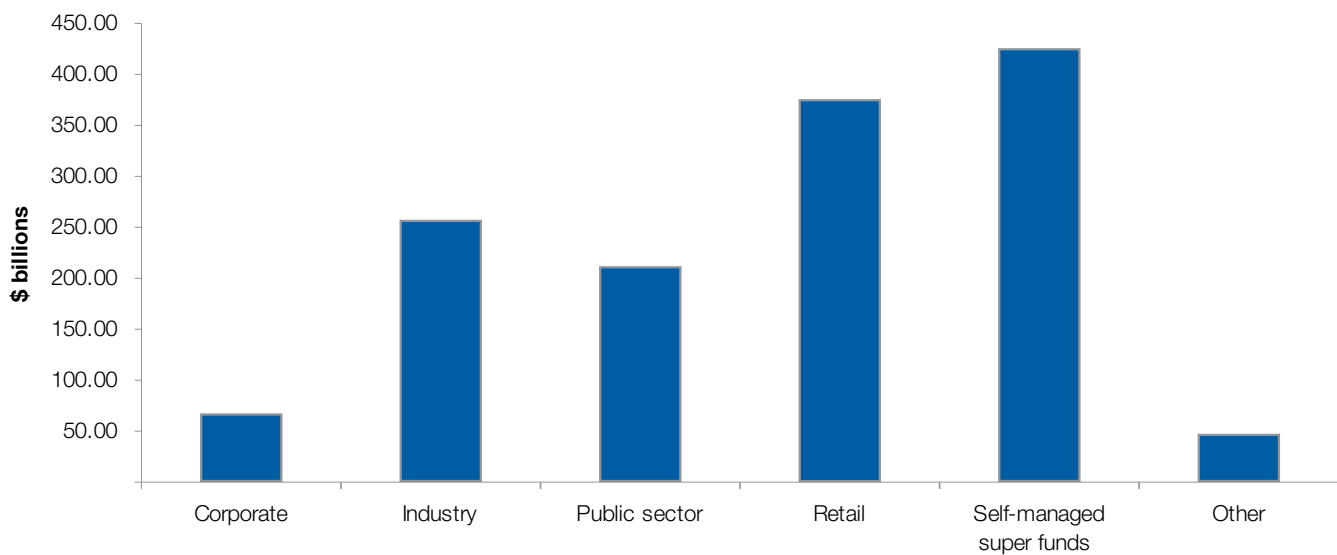
“Even the commentary in the half yearly report is flimsy at best. Cannot wait to kick off my SMSF.”

CPA Australia poll respondent comments

Background

The superannuation guarantee (SG) has been operational since 1992, compelling a majority of the Australian workforce to pay a fixed percentage of their earned income into a superannuation scheme. This contribution currently stands at 9 per cent of earned income, with an increase to 12 per cent in the offing as a result of the recent introduction of a Bill into Australian Parliament. According to the most recent statistics published by APRA, the Australian superannuation industry had an estimated \$1.34 trillion invested in a range of assets by the superannuation funds that make up this sector for the quarter to June 2011. The five main fund types that make up the Australian superannuation fund industry are: corporate funds; industry funds; public sector funds; retail funds; and self-managed superannuation funds (SMSFs). Figure 1 below depicts the breakdown of assets held by the different fund types at June 2011.

Figure 1
Assets held by superannuation funds – June 2011



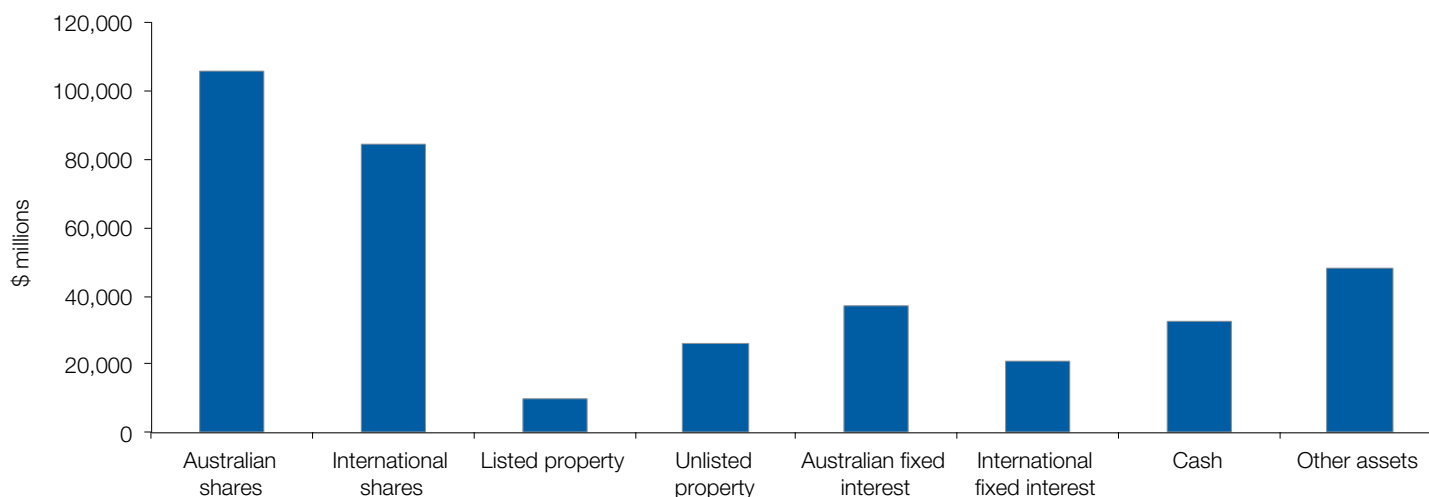
Source: APRA quarterly statistics, June 2011.

While the need for higher transparency and better reporting may be fundamental to some fund types, such as retail or industry funds, it may be less relevant to others. For example, in SMSFs the trustees and members are normally the same, and many of the governance and reporting considerations that apply to larger externally managed superannuation funds do not apply to this sector. Also, within different fund types, individual superannuation entities adopt different levels of transparency and disclosure. This paper seeks to explore reporting and transparency within the Australian superannuation industry in general and the issues highlighted, while relevant to some fund types, is likely to be less relevant to others, such as SMSFs.

Superannuation funds normally provide a range of investment choices, but if an employee does not make a choice, the contributions are paid into a “default” fund. It is notable that a substantial proportion of employees end up in “default” funds indicating some inertia in employees over investment choices. According to annual statistics published by APRA at June 2010, of the total assets held by superannuation funds with more than four members, 45.8 per cent of funds were held in default funds. A majority of default funds are invested in Australian and international shares, the remainder spread across bonds, term deposits, cash and other assets (Figure 2).

Both APRA and the Australian Securities & Investments Commission (ASIC) have regulatory oversight of the superannuation fund industry, apart from SMSFs which are regulated by the Australian Taxation Office. In its role as prudential regulator of the superannuation fund industry, APRA licenses and registers trustees, supervises compliance with legislation by examining annual returns submitted by superannuation funds, approves applications for superannuation funds to be regulated and oversees other prudential aspects. ASIC oversees product disclosures, regulation of corporate superannuation fund trustees and licensing financial product providers.

Figure 2
Asset allocation by default funds



Source: APRA annual statistics, June 2010.

Globally Australia is well regarded for its innovative and unique approach to providing retirement income. The \$1.34 trillion in superannuation fund assets makes it one of the largest retirement savings systems in the world. A recently published global index¹ (based on a study comparing the retirement savings systems of 16 countries from Europe, Asia, North and South America) ranked Australia second, behind the Netherlands. The study benchmarks each country's retirement savings system against a number of indicators grouped under the key attributes of adequacy, sustainability and integrity. Areas considered under integrity include regulation and governance, protection for members and costs. It is interesting to note Australia ranked fourth in the integrity measure, behind the Netherlands, United Kingdom and Switzerland.

The study suggests that with some improvements an "A grade" system or "the gold standard" is achievable in Australia. In Australia's case the recommendations made include imposing higher mandatory contributions and reducing costs through encouraging greater efficiency. Increasing mandatory contributions will happen once legislation to increase contributions from 9 per cent to 12 per cent passes. Reducing costs, however, is a much greater challenge. Understanding the costs of running Australia's superannuation system through better disclosure would be a step in the right direction.

The global financial crisis of 2008 highlighted some of the risks inherent in financial markets. As public confidence in the financial system deteriorated, government intervention was necessary in many countries to maintain stability. Issues around financial and economic stability continue to plague global markets. Australian superannuation funds are heavily invested in the capital markets and are not immune to the financial woes of other developed nations in the western hemisphere. If global markets continue to underperform the entire investment risk rests squarely on the shoulders of the fund member.

In May 2009, the Australian Government commissioned the Cooper review, charged with examining and analysing the governance, efficiency, structure and operation of Australia's superannuation system. The focus of the review was on achieving an outcome that is in the best interests of members and which maximises retirement incomes for Australians. The Cooper review made a total of 177 recommendations to improve the superannuation system. In responding to these recommendations, the government highlighted three key issues arising out of the review:

- fees in superannuation are too high
- choice of fund in superannuation has failed to deliver a competitive market that reduces costs for members
- there is too much tinkering in superannuation

The primary focus of this paper is to explore the role of reporting as a function in preserving the integrity of Australia's superannuation fund industry. An appreciation of current practices and issues surrounding governance of superannuation funds is also useful in better understanding reporting by superannuation funds.

Governance

Most superannuation funds operate under a trust structure, with the assets of the fund being held in trust by the trustees for the fund members. Trustees are expected to have the right skills and qualities, including independence, and are required to exercise care, skill and diligence in acting in the best interests of the fund members.

The appropriateness of the governance structures of some superannuation funds have been the subject of recent discussions. Specific concerns have been raised over inadequate processes to avoid conflicts of interest within trustee boards and management. A perceived general lack of transparency around board level activity within superannuation funds intensifies these concerns.

In recent months, media attention has focused on MTAA, the large industry superannuation fund. The fund reported a \$1.67 billion of negative investment income in the year to June 2009¹ and some commentators have pointed to the currency hedging strategies of MTAA as one of the causes.

The other notable case of recent times has been the failure of Trio Capital². Before its collapse, Trio was trustee of five superannuation funds and responsible for a number of managed investment schemes. Investors in one of these schemes, Astarra Strategic Fund, included superannuation funds managed by Trio, and some SMSFs and other direct investors. Following an investigation into Trio over the legitimacy of investments made by the Astarra Strategic Fund, Trio was placed into administration. The liquidators have since been unable to recover a vast majority of the assets.

The well publicised failure of Trio Capital, and the questions raised around governance and currency hedging strategies of the large industry fund MTAA have highlighted some wide-ranging concerns over the integrity of Australia's superannuation fund industry.

For Australia's superannuation system to maintain its integrity, good governance structures are essential and, to be effective, the operation of these governance structures needs to be clearly visible to the ordinary fund member. Valid concerns are raised about how best to address the visibility or transparency objective. Superannuation funds are complex, sophisticated operations and detailed disclosures could prove confusing and overwhelming. An equally compelling argument is that most fund members do not really care; most fund members even leave the decision making over fund choice to others, as evidenced by the number of fund members who end up in default funds. A further deterrent is the costs in achieving a high level of transparency – superannuation

funds argue that the additional costs incurred in providing detailed disclosures will result in lower returns. While member inertia and additional costs may provide valid reasons for taking a cautious approach to addressing transparency, the risks of inaction could potentially prove damaging in the long run with an ever increasing number of members taking retirement in the coming years.

“Making things more transparent doesn't necessarily help the situation, in terms of members being able to read and understand information presented to them.”

CPA Australia poll respondent comments

Superannuation fund members make investment choices in anticipation of returns and capital growth, a trait shared with investors in listed entities; the one key difference is that investment in listed entities is not compulsory. Unlike superannuation funds, extensive externally imposed requirements are placed upon listed entities through legislation, listing rules, corporate governance principles and other best practice guidelines in recognition of the risks undertaken by investors. While some of these imposed requirements, such as detailed and prescriptive prospectus information for fundraising and the application of an extensive framework of accounting standards in financial reporting and external audit, are statutory requirements, other requirements such as audit committees, board remuneration committees and internal audit are imposed through corporate governance rules that, while not legally mandated, are essential for the maintenance of listed status and investor confidence.

As part of the “Stronger Super” reforms, APRA is expected to have greater powers to set prudential standards that financial institutions, including superannuation funds, will be required to follow. In addition to the “MySuper” and “SuperStream” package of measures, the reforms seek to strengthen the governance of superannuation funds through the introduction of trustee duties. The duties will require funds to put fund member interest ahead of other interests, strengthen requirements around management of conflicts of interest, increase the standard of care, skill and diligence required by trustees and strengthen requirements around conduct of directors of corporate trustees.

1. MTAA Super Fund Annual Report 2008-09

2. ASIC media release 11-133MR

Disclosure – why, what and how

Retirement savings systems mature over decades and their preservation is an enduring responsibility. The question of who should be accountable for the preservation of Australia's retirement savings system is a difficult one to answer. The government shares some responsibility through legislation and regulation but ultimately, as a result of the unique design of the Australian retirement savings system, it is the ordinary fund member who shoulders most of the responsibility. It is therefore essential that built-in checks and balances ensure the continuing integrity of Australia's retirement savings system. Some reasons for this are:

- Contributions to superannuation are compulsory; and the contribution levels are likely to increase to maintain sufficient retirement income for participants.
- Australia holds one of the largest superannuation fund asset pools in the world relative to the size of its economy.
- An overwhelmingly large proportion of superannuation funds are managed by the private sector.
- All investment risks are borne by superannuation fund members.
- The relative immaturity of the system means the success (or failure) of the system will not be revealed for a few decades.

Prior to publishing this issues paper, CPA Australia polled members on some simple questions about reporting by superannuation funds (see Appendix). More than 75 per cent of respondents felt there was a lack of transparency around costs and underlying asset investments, and that reporting should be of the same standard as listed entities. Approximately 90 per cent of respondents agreed with the suggestion that there should be more transparency around trustee remuneration, senior executive remuneration and management fees paid to investment advisers.

The CPA Australia member poll indicates a need for more transparency in the following key areas:

- funds structure and performance
- costs transparency
- full audited financial statements

Funds structure and performance

The detailed disclosure of investment portfolios, including their structure and performance, is seen by many as essential for the integrity of Australia's superannuation industry. Those opposing greater disclosure point to higher costs and preservation of competitive advantage through protection of investment ideas and strategies as reasons for not providing detailed disclosures.

Most members invest in a variety of multi-sector funds labelled as growth, balanced and conservative funds. Some commentators consider the descriptors used to be inadequate and misleading. For example, a "balanced" fund could have a portfolio containing 70-80 per cent invested in growth assets, with only 20-30 per cent

in conservative assets. Different labels are placed on different types of balanced funds including moderate balanced, balanced growth, diversified balanced, active moderate and moderately defensive. Without specialist advice, it is unlikely that an ordinary fund member will appreciate whether the investment mix within the fund they have selected matches their risk tolerance. The other area of concern is that members make their choice based on past rather than projected performance, which could lead to inappropriate decision making.

“What should be transparent is the investment strategy, how funds are protected from serious devaluation, what strategies super funds are employing to ensure good performance and that contributors are not just throwing away their money at poor performing investments. I would like to pay good money for good performance.”

CPA Australia poll respondent comments

In seeking to address the above concerns, the Cooper review recommended disclosure of a standardised forward-looking measure of risks and volatility. This recommendation has resulted in a new requirement under the government's Stronger Super program – from June 2012 APRA will require superannuation funds to identify and disclose the risk of negative returns over a 20-year period for each of their investment options on a standardised basis. The standardised risk measure will have seven risk bands, ranging from "very low" to "very high", with a definition of what these terms will mean in relation to the chances of a negative return in a 20-year time period. The standardised risk measure will be part of Product Disclosure Statements (PDS) published by superannuation funds. The Association of Super Funds of Australia (ASFA) and Financial Services Council (FSC) have together produced a guide for trustees to comply with APRA's requirements.

Costs transparency

Many commentators, including Greg Medcraft, chairman of ASIC and Jeremy Cooper, chairman of the Cooper review panel, have expressed views that costs disclosures by superannuation funds need improvement. The CPA Australia member poll supports this view, with a majority of respondents indicating that additional disclosures are required around trustee and executive remuneration, and management fees paid to investment advisers. Other costs respondents believe need to be disclosed include entry / exit and transfer fees, administrative overheads, marketing and advertising, investment write downs, insurance costs,

commissions paid and received, tax, audit and legal costs, related party fees, and travel and entertainment costs. These responses broadly align with the Cooper review recommendations for disclosures of all costs by trustees.

One argument put forth for limited disclosures around certain costs is that many superannuation funds adopt complex investment strategies with funds invested in multi-layered products, making it difficult to identify fund management costs separately from investment returns. For example, some funds disclose a “crediting rate of return” after deduction of investment expenses and tax. While this provides a standardised methodology to calculate and allocate net investment earnings to members, the netting off exercise masks true investment performance and costs.

In July 2010, then Minister for Financial Services, Superannuation and Corporate Law, the Hon. Chris Bowen MP, said: “Fees should be lower in Australia. I don’t think the size of our superannuation sector has translated into economies of scale as much as it should have in terms of fees, so I do think they can and should be lower.” CPA Australia recognises the challenges in identifying some of the costs of our superannuation system, but this needs to be balanced against the case for more transparency around costs to get a better understanding of the system’s efficacy.

“Overall costs of the fund’s management [should be disclosed]. The industry funds regularly talk about their low cost structure. I’m not clear why / how this happens.

“Administration fees deducted from member accounts and paid to the fund manager [should be disclosed]. These are normally combined with other fees (trustee fees, commission to advisers, insurance premiums) and aren’t broken down to reflect the performance of the fund manager.”

CPA Australia poll respondent comments

Full audited financial statements

The principle of full disclosure is well established in corporate reporting to address the needs of users who have no direct control over day-to-day decision making. Large corporate entities, including listed entities, are required to apply an extensive framework of accounting standards and make additional

disclosures as mandated by legislation in the preparation of financial statements. The financial statements are subject to external audit to certify that they are prepared in accordance with an applicable accounting framework and present a true and fair view of the financial performance and position. This mechanism provides stakeholders who are separated from management with an independently verified source of information about the performance of management.

The *Superannuation Industry (Supervision) Act 1993* mandates the preparation of audited financial statements by superannuation funds. The legislation does not stipulate the form and content of the financial statements. This is principally governed by accounting standard AAS 25 *Financial Reporting by Superannuation Plans*, last published in December 2005 (currently being revised by the Australian Accounting Standards Board). Superannuation funds are not required to lodge financial statements to APRA, although APRA requires the provision of other data in prescribed format under the *Financial Sector (Collection of Data) Act 2001* and APRA reporting standards. The Corporations Regulations 2001 requires provision of audited accounts to fund members, however there is an interim option to provide abridged accounts along with information as to:

- when full audited accounts will be sent or
- when full audited accounts will be available upon request

“The reporting is generally too little too late.”

CPA Australia poll respondent comments

There are no requirements at present for financial statements to include a management or trustees report providing a summary of management activities and highlights. Equally, there are no specific related party or other similar disclosures aimed at providing transparency around potential conflicts of interest situations. Calls for more disclosures in these areas point to some relationships between superannuation funds and other entities, especially within the industry superannuation fund sector, and other potential conflict of interest scenarios including multiple trusteeships.

Clearly additional effort and resources will be required to implement enhanced transparency. The assistance of government regulators and other stakeholders will be essential to provide for a reporting system that delivers clear, standardised information to fund members who seek comfort about their retirement income. It is possible that the transparency objectives could be made more cost effective through the use of web-based technologies.

What does the future hold?

The Australia superannuation system is ranked one of the best in the world, but significant effort is required from all stakeholders to preserve this position, and to achieve the “gold standard”. The current position of \$1.34 trillion in assets is expected to double in the next decade, with contributions increasing to 12 per cent in the coming years. As with any retirement savings system, the Australian superannuation system should continue to pursue a range of investment strategies that will provide a sufficient retirement income in future years.

The government, through Stronger Super, MySuper and other initiatives, is seeking to protect the integrity of the system. Regulatory measures are being enhanced by the regulators, including APRA, through the introduction of new requirements such as the Standard Risk Measure for Product Disclosure Statements.

The Australian financial system has remained relatively stable during and after the global financial crisis, and in comparison to other countries, Australia's superannuation industry remains relatively well-funded and robust. Mandatory contributions are set to increase to ensure the anticipated retirement income needs are met while the government looks to implement regulatory reforms aimed at enhancing public confidence in the superannuation industry. These are positive steps toward protecting what is a relatively immature industry that is set to grow steadily in the coming years.

In the coming months CPA Australia will look to establish the veracity of the identified issues through engagement with stakeholders and further research and analysis. CPA Australia will also aim to identify suitable opportunities to influence policy and inform change where appropriate.

There is nothing to suggest Australia's superannuation system is perched over a cliff edge, however it is important for adequate checks and measures to be in place to safeguard the system's integrity and secure Australia's retirement nest egg.

Appendix

CPA Australia Super Reporting Poll results

Do you believe there is a lack of transparency about costs that may significantly diminish the quality of superannuation fund reporting?

Yes – 78% **No** – 9% **No firm view** – 13%

Do you believe there is a lack of transparency about underlying asset investment that may significantly diminish the quality of superannuation fund reporting?

Yes – 76% **No** – 12% **No firm view** – 12%

As Australians are compelled to have investments in superannuation funds, do you believe that superannuation funds' reporting to members should be of the same standard as that required of listed entities?

Yes – 77% **No** – 13% **No firm view** – 10%

Costs – Do you agree that trustee remuneration should be made more transparent?

Yes – 91% **No** – 2% **No firm view** – 7%

Costs – Do you agree that senior executive remuneration should be made more transparent?

Yes – 89% **No** – 4% **No firm view** – 7%

Costs – do you agree that management fees paid to investment advisers should be made more transparent?

Yes – 97% **No** – 1% **No firm view** – 2%