

ACTU SUBMISSION ON “REFORMS TO SUPERANNUATION GOVERNANCE”: EXPOSURE DRAFT

27 July 2015

On 26 June 2015, Treasury released an Exposure Draft” in relation to legislation proposed by the Australian Government, known as “Reforms to Superannuation Governance”. Treasury invited interested parties to make written submissions on the Exposure Draft, to be received by 23 July 2015.

The Australian Council of Trade Unions (the ACTU) is the Peak Council representing trade unions in Australia. The ACTU has been active in the area of superannuation for more than 30 years, having led the cases in the Conciliation and Arbitration Commission in the mid 1980’s which led to superannuation becoming recognised as an industrial issue and leading to the insertion of superannuation clauses in Awards of the Commission and its successor bodies. The ACTU has also been active in the formation of a number of industry superannuation funds and, together with affiliated Unions, has largely nominated the Employee Representatives to industry superannuation funds.

Industry superannuation funds are generally operated through Trustee Companies which comprise Boards of Trustee/Directors operating under equal representation principles and appointed by the owners of the companies, which are generally the sponsoring Unions and Employer groups. These funds became the principal vehicles into which award superannuation, and later Superannuation Guarantee Contributions have mainly been paid. Industry superannuation funds are recognised to comprise about 30% of monies held in the superannuation sector and represent accounts held for approximately 8 million workers.

Industry superannuation funds have been one of the singularly most successful stories of the Australian financial sector over the past 30 years. Industry superannuation funds have, by and large, been the best performing sector of the superannuation industry, they have grown to represent the majority of the workforce, they have acted in a manner consistent with a charter to represent the interests of the members of the funds and they undertake the significant role of investing some \$300 billion of retirement savings on behalf of fund members.

The proposed reforms to Superannuation Governance will have a significant effect on the operation of industry superannuation. It may very well destroy the essential operating features of these funds which in turn would have a detrimental effect on the retirement savings of many working Australians.

As such it is appropriate the ACTU makes a submission on the proposed legislation. The ACTU opposes the legislation, saying that nothing short of it not progressing through the Australian Parliament would be the only solution to ensuring that the successful operating model of industry superannuation is maintained.

THE NATURE OF INDUSTRY FUNDS

Industry funds operate as “all profits to members” vehicles.

These funds were established by and large to be the recipients of Award and/or Superannuation Guarantee Charge contributions for Australian workers – essentially mandated contributions designed as one of the three pillars of the Australian superannuation and retirement savings system.

The funds were given, by the Government and ultimately, the Industrial Authorities, a unique position to be the “distribution vehicles” for Australia’s superannuation system. This distribution system was thus enabled to be established in a non-competitive, non-sales-oriented environment. The beneficiaries of this approach were Australian workers, who in other sense would have had to “pay” for a distribution system – through selling agents or the like.

As such, it was appropriate that the sponsoring organisations for these funds acted in manner to provide effective guardianship of the funds – mainly through the establishment of not-for-profit Trustee Companies to operate the Funds. These Trustee Companies have, by and large, not sought to broaden the scope of their operating mandate – which was to provide superannuation to the workers and employers covered by the “industry” in which they operate. They have not sought to create a competitive environment by seeking to cover workers in other industries, a step which would have needed to create a different philosophical approach in which their ‘product’ needed to be sold. At the heart of this alternative approach (that is product selling) is the conflict which has dogged the finance industry sector for many years – Agents, tied to a sponsoring organisation with a corresponding remuneration arrangement, selling that organisation’s product, acting in the Agent and the sponsoring organisation’s interest rather than the best interests of the member.

Industry funds have not had this conflict at the heart of their operations in that they have not had a selling culture to attract business. The orderly distribution system, through the Award system, has meant a culture of the actions of the fund being solely in the interest of the member. It is therefore no surprise that the industry fund sector has not had any exposure whatsoever to the financial scandals which have plagued banks and life insurance companies.

In addition to this, an industry fund does not pay a dividend or commission to its sponsoring organisations. Contrasted to this is the banking and life insurance sector in which the superannuation system is seen as another product offering, for which the organisation which has put up the capital to fund the development of the product, needs to be rewarded through a return on its capital. In a traditional

economic model, there would normally be a business case which said that that the banks or life insurance companies have been able to bring a scale of economy or an efficiency of operations to allow for members of funds operated by them to have cheaper products or they would have brought a level of expertise in investing these products for which they would have been able to obtain higher investment returns. The converse has operated – the industry funds have generally operated on a cheaper cost model and have generally returned significantly better investment returns. Further, in those instances where the bank’s or life office’s fund has been the default fund, in addition to higher administration fees and lower investment returns, the member has actually had to pay a further dividend to the corporate entity of the bank or life insurance company as to what they would have had to pay had he or she been a member of an industry fund.

And the ACTU says rightly so should the features of the industry fund model exist. Superannuation Guarantee Contributions are mandated contributions to support public policy. There is no special selling feature for which an entity should receive a commission based reward – in the public interest the most efficient, cost effective distribution system should exist and no Agent or for profit organisation should receive a special commission for “selling” a Government mandated product.

The ACTU says the very nature of the current system will change should the Government’s proposed reforms pass the Parliament. In the name of bringing in Independents to Boards (together coupled with other stated Government aim to “free up” the distribution model) a culture of acting in the business interests of the Trustee Company is being created. Trustee Companies will now need to act to compete for members – hence introducing the need for a new form of distribution system. And with a Board specifically structured with “business expertise” and a common law duty to act in the interests of their corporate body, the very nature of the all profits to members system comes under threat.

The ACTU says this will be to the detriment of Australian workers.

The ACTU says this will be the case even in a model where the Government’s prescription is for 1/3rd of the Directors to be Independent. It is the history of similar organisations that Boards of this nature, coupled with the desire of a management group seeking to advance the corporate interests of their businesses, inevitably end in a “more competitive” landscape than the “collaborative” type of model which has successfully operated for the past 30 years.

And of course, the Government seeks to fast track this process of corporatizing Boards by a number of the features of the proposed changes to prudential requirements – particularly in the powers it says the prudential regulator should have to do the following:-

- Requiring Boards to report on an “if not, why not” basis as to why their Board doesn’t have a majority of Independents on it;
- By overriding shareholder rights to have a say in the construction of the Boards of the companies they own;
- By giving the Regulator (APRA) the power to determine the status of individuals as to whether they satisfy a manufactured definition of Independent;
- By place regulatory tenure limits on experienced Directors and requiring Boards to have plans to “mange” people off Boards during transition periods;
- By establishing Nomination structures which self-perpetuate the Independent’s control of the organisations; and
- By removing the requirement to have a representative system of governance, thereby taking away a requirement that there be a form of member representation amongst the Trustees.

And in doing so, there is no doubt that the not for profit culture will be replaced by a for profit corporation at the heart of the funds’ operations.

The ACTU supports an approach which promotes good governance amongst superannuation funds. It is the ACTU’s view that this is best achieved when Boards are constructed to provide a set of overall skills and experience – a composition which works cohesively with a unity of purpose at its heart, with good dynamics and a culture of integrity and good decision-making. These are not issues easily prescribed by legislation. The ACTU supports continuing to work to establishing industry-wide cultures which reflect this approach, but does not believe trying to re-fashion Prudential Standards in the approach being adopted is a satisfactory approach to achieving these goals.

It should be asked why are these changes to the structural operation of the sector being pushed so forcefully by this proposed legislation.

Is it because the sector hasn’t been cost efficient and/or has underperformed in the returns to the members – it can’t be because all the evidence from industry bodies will say this is not the case.

Is it because there has been a failure of governance – it can't be because in fact the sector has shown itself to be robust in meeting its challenges and has in fact been free from scandal. Contrast this to the Government's preferred model in which at the heart of every finance industry sector scandal of recent years has been an Independent Board promoting a for profit model, selling its product through a conflicted distribution model.

Is it because there is a lack of skill base on the Board or a lack of governance rigour in which Boards are not independent enough from internal management – it can't be because Industry funds have a record of utilising high profile Independents already to promote additional skill and bring high levels of corporate governance. Continued high quality performance and the lack of controversy around the sector are rebuttals to this possible line of reasoning.

Is it because industry funds won't be able to access high quality investment personnel or have the expertise to undertake the complex transactions of a developing economy – it can't be because Industry funds have been the fastest innovators in the areas of investment performance and their current scale of operations is such to ensure they have the capacity to continue to attract investment expertise to meet the investment demands of the future.

Is it because there is a view that adding Independents to Boards will add to the investment performance of the funds – it can't be because there is a body of research which says there is no real link between the introduction of Independents to Boards and improved investment performance; in fact some literature points to performance being harmed by the introduction of Independents.

Is it because industry funds will be conservative and not consolidated when consolidation might lead to greater scales of economy – it can't be because Industry funds have a better track record of mergers than other sectors and utilise collective vehicles already to maximise the scale of economy from the purchasing power a combined membership might bring them.

Is it because industry funds have not been able to adequately handle issues like risk management or conflicts of interest – it can't be because APRA, in its regular prudential reviews of the operation of industry funds has not identified a single issue in which the funds have not adequately and appropriately managed risk and conflict.

If not these issues, then what are the issues which might cause such a change which has the potential to so radically overhaul the operating model of the nation's superannuation system. Unless the Government can identify valid reasons for such fundamental change, then the ACTU says that the current successfully operating model should remain as the dominant model in providing superannuation.

Further the ACTU says this issue should be examined in the risk assessment terms it advocates as the appropriate framework to evaluate business operation in the finance sector. The Parliament is in fact taking a decision to change the operation of a system which entails a risk to the efficient delivery of superannuation to the nation's workers. The risk is that these decisions will create an operating model which is fundamentally different to the one which has underpinned the success of superannuation in this country for 30 years. Nobody should entertain such a risk unless there are clear reasons for making the change, low potential for impact on the beneficiaries of the system and a clear plan to measure the success of such a change.

No case has been made in these areas. In fact, all the evidence points to the residual impact of these changes being extreme. In such circumstances it is not appropriate to proceed with the changes proposed.

ACTU ROLE ON AUSTRALIANSUPER

The ACTU, alongside a number of affiliated Unions, provides the employee representation on AustralianSuper – the largest industry superannuation fund.

The ACTU is aware that AI Group, which is the employer shareholder on the Trustee Company which operates AustralianSuper has made a submission on the Exposure Draft. That submission offers a number of observations on the operations and the success of AustralianSuper.

The ACTU also believes AustralianSuper has been a very successful industry fund with an underlying culture which has contributed to that success. In respect of the issues raised in The AI Group submission, the ACTU for its part believes the following factors are relevant:-

- We believe the success of AustralianSuper is very much a case of the operating structure of a not for profit fund acting mainly as the recipient of contributions arising from the Award/SGC default fund system and the governance culture which has underpinned that fund.
- We have supported the value which has come through the appointment of Independents and we believe this has occurred through both the approach to carefully selecting Independents who understand and work with the culture of the fund – a culture, in our view, which is intrinsically linked to the equal representation model and the 2/3rds majority on decision making.

ADDRESS

ACTU
365 Queen Street
Melbourne VIC 3000

PHONE

1300 486 466

WEB

actu.org.au

D No: 99/2015

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