Trustee obligations: How to tell the new story to members

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Introduction

The superannuation sector is undergoing major change stemming from regulatory reform, industry consolidation and growth, and changes in investor behaviour. These reforms and other market changes are going to cause trustees to have to tell new stories to their members—about asset allocation, risk, returns and fees—although arguably, these are the stories that members should have been told some time ago.

Today, as well as discussing immediate challenges like bedding down the standard risk measure, or implementing shorter Product Disclosure Statement (PDS) reform, I also want to consider longer term themes that will provide challenges for ASIC and industry over the next decade, including:

- growth in super
- industry consolidation
- adopting a longer term perspective more generally for the benefit of members
- increased disclosure and transparency
- the growth of self-managed superannuation funds (SMSFs).

Growth in super

As superannuation grows from $1.4 trillion now to a forecasted $3 trillion in 2020 to $6 trillion by 2030,[1] investors will have greater funds to invest. This can lead to increased complexity in the financial system as trustees broaden their investment horizon in order to appropriately manage this bigger pool of funds. As super outpaces gross domestic product we may see an increase in international exposure, shifts from equities and a corresponding impact on the equities market, and an increased appetite for fixed income securities.

Increased complexity generally means increased risk, and a greater importance on ensuring disclosure with members keeps pace so members continue to understand their investments and the risks they are taking.

Super fund trustees, financial advisors, investment managers, administrators, custodians, research houses, credit rating agencies, auditors and accountants will be impacted by the growth in super, as their role in supporting investors will become ever more critical.

The need for good-quality advice and consumer information will increase as the baby boomers retire and begin to draw down on their superannuation or receive lump sum payments, or as they switch to more conservative assets.

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[1] Deloitte, *Dynamics of the Australian superannuation system—The next 20 years: 2011–2030*, November 2011.

There is also potential for a shift in funds' focus. Competition in the industry is generally focused on the accumulation phase, where it's based largely on fees and benefits. We may soon see a shift to offerings in the retirement income space, suggesting a more balanced approach. Supporting this suggestion is an increase in funds adopting 'life cycling'—offering segmented membership within the same fund, with the funds' strategy automatically changing to adapt to the members' current life cycle needs.

Further, our ageing population means there will be an increased focus on the needs of members in the retirement phase. Trustees are well aware of the need to offer pension products to members and, in the longer term, we may see Australian Government initiatives to support people keeping their money in the super system rather than taking lump sums and moving out of super altogether.

Our ageing population also means there are older funds with an older member demographic and with declining funds. We can expect to see some mergers of funds as a result.

Industry consolidation and increased complexity

The current trend in superannuation fund consolidation is anticipated to continue, as industry funds merge, are acquired and internally integrated. There may also be reorganisations within wealth management groups. This may be in part due to both anticipated Stronger Super reforms and the extension of capital gains tax relief until 2017.

In 2010–11 the number of 'large funds'—more than four members—regulated by the Australian Prudential Regulation Authority (APRA) decreased from 426 to 386. At 30 June 2011, the 20 largest superannuation funds accounted for 59% of the assets of all large APRA-regulated super funds.

As with any other significant event, trustees need to inform members of a decision to merge or consolidate their fund with another super fund. ASIC wrote a letter to industry last year reminding them of their disclosure obligations in this regard.

Subject to the passage of legislation, you will be aware that all trustees of super funds will be required to offer a MySuper product from 1 July 2013—a superannuation product with a simple set of product design features and potentially cheaper fees, so consumers can more easily engage with their superannuation—if they want to accept default members. It remains to be seen how MySuper accounts will impact on competition. For example, under MySuper, a trustee's obligation to actively consider (on an annual basis) whether the fund has sufficient economies of scale to continue could drive greater consolidation within the sector.

The increasing complexity of the financial system, in terms of products, information channels and financial markets, may also pose an increased risk.

In the wake of the global financial crisis, the problem of unsuitable and highly complex products being mis-sold to retail investors has become apparent. ASIC has a team dedicated to better understanding complex products. One of our priorities is to focus on advertising so we continue to ensure consumers are not misled.

Adopting a longer term perspective

Superannuation is a long-term investment made for the purpose of funding members' retirement. So it is perplexing that so much of our behaviour and disclosure focuses on the short term. We need to find ways to instil a longer term focus by investors and industry, so the fund investments and services can fund a retirement that's in line with members' changes in living standards.

Our observation is the industry has gone some way along this path. For example, retirement projection calculators and industry estimates of retirement incomes (published by ASFA) tend to be on a wage-based index, which better reflects member's changes in living standards. ASIC provides guidance on what you need to do if you wish to rely on our relief to give retirement estimates to your members.

Trustees should continue to frame their disclosure, advertising and other communication with investors with the long-term nature of the investment in mind. In some parts we have observed industry does a good job focusing on the long term—however, there is always room for improvement. The Stronger Super reforms recognise the importance of the long term. Indeed, the first element of the proposed product dashboard under the Stronger Super reforms requires the disclosure of an investment return target. While it is yet to be settled whether this target will be over a 10- or 20-year period, this is certainly a measure designed to look to the longer term.

At ASIC, we also use a wage-based index for our MoneySmart retirement calculator. The age pension is also aligned to a wage-based index.

The area in which we think a wage-based index, such as average weekly ordinary times earning (AWOTE), should also be used is to describe investment objectives—for example, in the product dashboard. Our research shows there are a number of different types of benchmarks currently being used internationally, each telling the investor different information. There is currently no prescribed method or regulatory requirement on how superannuation funds are to state investment objectives by reference to a wage-based index, such as AWOTE or the consumer price index (CPI), although we anticipate the Stronger Super reforms and, specifically, APRA's data collection requirements may provide clarity.

We know industry often uses CPI. However, we think that a wage-based index like AWOTE is a more appropriate index than CPI for two reasons.

First, as previously stated, it better aligns the objectives with members' retirement expectations. Without making this alignment, a member at retirement may fall short of their desired retirement income level, even though they were invested in an investment that met its CPI-based objective throughout their time in the fund.

Second, relating return aspirations to CPI sets the bar too low. Members should expect a benchmark that takes into account the state of the economy, including economic growth. Unlike CPI, a wage-based measure like AWOTE broadly reflects per capita economic growth in Australia, which is relevant where most superannuation fund assets are Australian based. Measuring the return target above AWOTE would better reflect the degree of extra risk taken on by the fund.

But even if we 'improve' information and tools to enable investors to focus on the long term, it will not be enough. The industry needs to move to a longer term focus for performance and culture. This is difficult in such a competitive environment, where attention is focused on costs and returns, and we are more confident in estimating costs and returns in the short term. We should be aiming to develop better tools for estimating longer term costs and returns and, where these exist, use them as a preference. We should give the longer term costs and returns at least the same, and perhaps greater, management time and attention as we do short-term costs and returns.

We should also consider how best we might employ other benchmarks, such as measure of risk, that better reflect a longer term perspective. The industry has made a good start in developing the standard risk measure and this can be the basis of further developments in improving the information available to investors to make longer term decisions.

If industry leads the way in adopting a long-term perspective, investors are likely to follow. It is important to align the thinking of industry and investors in adopting this long-term approach so all stakeholders are on the same page. In some cases, small changes in practice will help change the mindset of all. For example, if appropriate in the context of your disclosure obligations, when you present your returns information in investor documents or in comparative tables, we suggest you state the long-term information first, then shorter term information.

Similarly, where there are no prescribed short-term performance disclosure requirements, short-term performance should not be used. This focuses investors'—and your—attention on the long-term scenario and adjusts investors' expectations. This mirrors the expectations of investors in different sectors—for example, infrastructure assets, where investors and industry focuses on returns sometimes 30–40 years ahead and all parties are aware of (and accept as standard practice) the ups and downs of the investment to get to this long-term position.

I also do wonder whether some of the criteria used to hand out industry awards, such as the fund of the year, are appropriately aligned with members' long-term objectives. It seems to me that awarding a fund partly based on short-term performance may not be well aligned with these objectives.

Increased disclosure and transparency

ASIC's first strategic priority is confident and informed investors and financial consumers. Disclosure and transparency is fundamental to achieving this. The compulsory nature of superannuation and its significant role in the retirement of all Australians arguably raises the threshold of what the community expects from disclosure and transparency.

Disclosure will evolve as funds embrace greater transparency and as the reforms take hold. Funds will need to ensure transparency carries across any form of member communication, including advertising, web, and mail outs. As members have more information about their investments, their understanding of superannuation in general and their fund in particular is expected to improve—so they'll want more sophisticated messaging in advertising and disclosure, including periodic statements.

Education will also continue to play an important role, as it will improve members' level of engagement and understanding of the additional information available. This will continue to be a key focus for ASIC, and we welcome industry initiatives to the same aim.

The regulatory reforms will result in regulators publishing information on their websites regarding financial positions of funds, which means the funds should be using this as an opportunity to be upfront and transparent about their position, and ensure investors are receiving the information in the appropriate context of the fund's position, to avoid scaremongering or misunderstanding.

In an increasingly converging superannuation sector, ASIC will continue to ensure fund members are sufficiently confident and informed. We will continue to monitor changes in the superannuation landscape and consult with industry associations to ensure fund members are sufficiently protected.

Our goal is to build investor confidence and improve disclosure practices. The Stronger Super reforms introduce new disclosure requirements, which it is anticipated ASIC will regulate. Subject to the final form of this legislation, we will provide regulatory guidance on the following aspects of disclosure:

- s29QC and the alignment of data collection and disclosure requirements
- product dashboards
- portfolio holdings disclosure
- executive remuneration disclosure.

I will turn to each of these topics now, and also cover other disclosure areas of interest to ASIC.

Section 29QC

One part of the Stronger Super reforms that may not be widely understood, but is absolutely critical, is the proposed s29QC of the *Superannuation Industry (Supervision) Act 1993* (SIS Act). This section requires consistency between disclosure to the public and what is reported to APRA under their data collection requirements. It forces consistency of methodology in the calculation of matters such as returns, performance targets and fees.

Section 29QC is a strict liability offence provision ASIC will enforce, but in relation to which we have no relief power. What it means is, for example, if APRA collects data in relation to risks based on the standard risk measure developed by ASFA and the Financial Services Council (FSC), trustees must include the standard risk measure in their product dashboard.

It is important to remember this section, particularly in considering the five key elements in the product dashboard requirements.

Product dashboard disclosure

Product dashboard information will be included on the public website of a trustee to provide a snapshot of the fund. ASIC will have stop-order powers if there is misleading information included in the product dashboard. The product dashboard requires disclosure of:

- the investment return target for the product
- the number of times the target has been achieved for the product in the last 10 years—or if the product hasn't been in existence for 10 years, in each of the years in which the product has been offered
- a statement about liquidity
- the average amount of fees charged in relation to the product during the last quarter, expressed as a percentage of the assets of the fund attributable to the product at the end of the last day of that quarter
- the level of investment risk that applies (ASIC and APRA agree this should be the ASIC–FSC standard risk measure).

We are currently aware that there is inconsistency in the manner in which the management fees or management expense ratio is currently calculated and disclosed. This is a problem across the superannuation and managed fund industry, which we have recognised and will be taking a closer look at in the future with the aim of better consistency and accuracy. The dashboard and APRA's expanded data collection will assist.

To date, there has been considerable feedback from trustees to both APRA and ASIC about these elements and the data collection methodology that should be used to support them.

Portfolio holdings disclosure

ASIC considers disclosure of the portfolio holdings of superannuation funds a key part of the sector's transparency. We want Australians to engage with their superannuation.

Investors are entitled to know where their money is actually invested. Portfolio information will help investors assess their level of diversification across their superannuation and non-superannuation assets. This includes knowing the economic exposure of their investments that may be obtained through the use of derivatives.

We also think that it would be beneficial if trustees and regulators help explain to consumers the benefit of this information and the use that can be made of it.

These reforms propose underlying managed investment schemes will need to make portfolio holdings information available to an investing superannuation fund on a 'look-through' basis. In our experience, many superannuation funds invest in managed investment schemes.

It is therefore essential for underlying managed investment schemes to make portfolio holdings information available to the investor superannuation fund. In turn, many managed investment schemes invest in unregistered wholesale managed investment schemes. Consideration should be given to the extent to which wholesale managed investment schemes must make portfolio holdings information available to feeder funds.

Portfolio holdings information of superannuation funds will have a positive impact on managed funds and the broader investment industry. As a result of these reforms, we may see managed investment funds making available their portfolio holdings information as well. We consider transparency and accountability principles being applied in superannuation to be well suited for the managed funds industry.

Portfolio holdings are already being disclosed in other countries such as the United Kingdom and the United States.

Recent research places Australia equal 15th out of 22 countries in terms of disclosure quality, which includes portfolio holdings disclosure. The disclosure requirements will no doubt require a change in mind set for trustees, and may drive investment in other assets such as cash, fixed income and infrastructure. It may also cause trustees to consider whether offshore investments are appropriate for their fund. Trustees may find that their membership base starts to provide feedback on some of the investments being made, or that they vote to leave if the portfolio holding mix is not to their liking.

Executive remuneration

MySuper reforms will require the remuneration of executive officers to be disclosed and be kept up-to-date on a trustee website. Further details are anticipated in the regulations; however, we expect the standard of disclosure to be comparable to the standard that applies to listed companies, although the definition of 'executive officer' may apply to more people than the current listed company requirements, which apply to 'key management personnel'.

Further, the explanatory memorandum to the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 foreshadows the release of further regulations, which will require the disclosure of:

- the biographies of directors of the fund
- details of directors' attendance at board meetings
- the fund's proxy voting policies and voting behaviour.

Shorter PDS regime

The shorter PDS regime started in full in June this year. The regime is designed to make PDSs shorter and simpler, and help consumers compare financial products more easily.

ASIC has provided interim class order relief to allow the Australian Government to settle its views on whether multifunds, super platforms and hedge funds should be in (or out of) the shorter PDS regime.

Some aspects of the application of the shorter PDS regime are still under consideration and, in some of these cases, ASIC is adopting a monitoring approach to see how people respond to the changes. Where there are different approaches taken by industry to certain aspects of the regime, we will monitor industry's approach to these requirements and, if necessary, liaise with Treasury regarding the need for further clarification.

ASIC is currently taking a facilitative approach to compliance for the first six months post-commencement of the shorter PDS regime. Provided industry participants are making a reasonable effort to comply with the shorter PDS regime, ASIC will adopt a measured approach where inadvertent breaches result from a misunderstanding of requirements or systems issues. Deliberate and systemic breaches will, however, be subject to stronger regulatory action. Also, once the six-month facilitative time period concludes (early next year), ASIC does anticipate reviewing a number of shorter PDSs to check the levels of compliance more generally with the new shorter PDS regime.

We are also working to integrate the standard risk measure disclosure (based on the ASFA–FSC guidance) into the shorter PDS regime.

Standard risk measure

Launched in August 2011, the standard risk measure discloses the level of risk in superannuation to consumers. This reporting started in June this year.

It is the product of an ASFA and FSC working group, and is supported by ASIC and APRA.

The measure has seven risk bands, ranging from 'very low' to 'very high', and sets out what these terms will mean in regards to the chances of a negative return in a 20-year time period. Super fund members can more easily compare investment options within their fund, as well as make comparisons across superannuation funds. Further information about ASIC's compliance expectations for the measure is in our Information Sheet 155 *Shorter PDSs: Complying with requirements for superannuation products and simple managed investment schemes* (INFO 155).[2]

Reinforcing my theme of greater transparency and improved disclosure, we think one further step in standardisation that will be of assistance to investors is standardised labelling.

The asset allocation and investment objectives of various funds or investment options that are similarly labelled can be quite different. For example, a balanced investment option can have an asset allocation varying from 50–80% growth assets and still be referred to as 'balanced'. Growth assets could simply be made up of Australian shares or a mix of Australian and international shares as well as other assets.

Standard categories of investments, whether by asset allocation, risk–return profile or some other appropriate categorisation agreed to by industry, will help reduce investor confusion and further improve transparency. We support industry initiatives in this regard and note that the standard risk measure has made a start, at least in regards to conservative options.

[2] http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/info155-published-18-June-2012.pdf/$file/info155-published-18-June-2012.pdf

I should also note that the standard risk measure is one of the elements (under the 'risk' heading) that will be required by law in the product dashboard.

The rising popularity of SMSFs

In any consideration of the Australian superannuation landscape, it is important to also consider SMSFs. There is a risk that a substantial minority of consumers will end up in SMSFs without adequate resources and an adequate understanding of the risks involved in investing outside of the protections of regulated super. ASIC is concerned inappropriate advice and aggressive marketing of SMSFs have the potential to lead to significant problems in this sector and undermine the goal of adequate retirement income.

According to statistics from the Australian Tax Office (ATO), there are approximately 480,000 SMSFs with a total of $439 billion assets (invested in Australia and overseas).[3] That is, SMSFs hold an almost one-third share (31%) of the total $1.4 trillion superannuation assets in Australia. According to the most recent ATO data, around 60% of SMSF assets are in listed shares and cash and term deposits. SMSFs also invest in more complex products, but this is less common.

Potential SMSF investors may use MySuper as the benchmark for choosing whether to move from the APRA-regulated environment and take up the compliance risk of running their own SMSF. Control and lower costs (for those with sufficiently high balances) remain the main drivers for establishment of SMSFs, but the introduction of MySuper may provide an alternative choice by offering simplicity and low-cost superannuation investment in a more regulated environment. This may especially be the case where the assets invested in tend to be cash and cash products, as well as blue chip shares and property. Indeed, improvements in the APRA-regulated fund space more generally, as a result of the Stronger Super reforms, may encourage people to stay in that sector.

We may also start to see more trustees of super funds trying to stem the move of funds away from APRA-regulated superannuation into SMSFs by increasingly providing more options for do-it-yourself super through the super fund itself. The initiatives include offering funds with SMSF-like features that enable greater investor control over, for example, share trading. What trustees need to remember with these offerings is that the disclosure and other obligations of the trustee don't change just because they are offering fund features more akin to SMSF offerings.

[3] http://www.ato.gov.au/superfunds/content.aspx?menuid=0&doc=/content/00332225.htm&page=6&H6

Increasing your fund's transparency also gives you a greater ability to compete with the SMSF market. As mentioned, one of the major drivers for investment in SMSFs is the control investors have over their super investment. They know what they are invested in, how much it costs, and are able to access their investment information.

Trustees of large funds can compete by improving their funds transparency. The more information you have about who's running the fund, costs and underlying investments—the drivers that induce SMSF investors—the better chance you have of retaining members who would otherwise roll their investments into an SMSF, as you provide them with more flexibility and choice. Transparency can arguably offer the best features of the SMSF structure, but investors are not required to meet the administrative obligations. We understand some of the larger funds are also looking to compete by offering some individuals an opportunity to move from their fund to an SMSF set up by the fund trustee—who holds an Australian financial services (AFS) licence authorising them to give advice—effectively moving into an SMSF through the advice model.

While we are seeing increased growth in this sector, it is pleasing to see large funds adapting to embrace the opportunities for continued competition.

The quality of advice investors receive may be crucial to them making good financial decisions. To ensure ASIC takes steps to manage the risks in this area, we have also established an internal taskforce to deal with SMSF issues and our Financial Advisers team is also focusing on a number of projects to help improve the quality of advice given to SMSFs.

Further, SMSFs themselves are being subjected to greater accountability measures as part of the government reforms and this increased pressure on SMSFs may prove an encouragement to stay with the larger regulated funds. Under the Stronger Super reforms, there will be increased penalties from the ATO for SMSF trustees, including the ability for the ATO to require mandatory education for SMSF trustees where they have failed to comply with the SIS Act.

The Stronger Super reforms also focus on the qualifications, competency and professional standards of SMSF auditors as key gatekeepers. Minimum standards aim to achieve greater consistency and more importantly, provide SMSF fund members with greater protection by reducing the risks to superannuation savings.

ASIC's increased role under the Stronger Super reforms, with regard to SMSFs, is to:

- build and manage the SMSF auditor register (which will be able to be searched by members of the public)

- implement the new auditor requirements around competency and independence
- take action against non compliant auditors
- provide support to registered SMSF auditors.

ASIC's super website and stronger super implementation proposals

ASIC has initiatives designed to assist industry to understand their regulatory obligations under the Stronger Super reforms, including SMSF auditor registration. The initiatives include:

- a superannuation page on our website[4]
- a timeline of regulatory documents
- industry roadshows.

Website

ASIC's dedicated superannuation page helps industry understand ASIC's role in superannuation, provides information about the reforms and detail new requirements. This is in addition to information available on ASIC's MoneySmart website at www.moneysmart.gov.au. Queries about Stronger Super can be emailed to ASIC at StrongerSuperReforms@asic.gov.au.

Regulatory guidance timeline

Depending on the final passage of legislation, ASIC expects to provide guidance for SMSF auditor reforms next month. We also intend to issue guidance on disclosure issues associated with the Stronger Super reforms, such as the new portfolio holdings and product dashboard requirements. The guidance we are likely to provide about these disclosure topics will be informed by any regulations that are made that impose requirements about the structure and content of the information that must be disclosed. Some of these regulations are yet to be released. We have recently met with industry to discuss the areas where the industry feels guidance is most warranted.

ASIC will amend existing regulatory guidance and ASIC relief to reflect the Stronger Super reforms where necessary. These consequential amendments to existing regulatory guidance may not all occur before commencement of the Stronger Super reforms.

[4] http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Superannuation%20overview

Roadshows

ASIC and APRA conducted roadshows in October around the country. The roadshows were hosted by the Australian Institute of Superannuation Trustees, and were a forum to explain the new disclosure requirements that are being introduced and to allow people to ask questions directly to ASIC. By all reports these roadshows were successful and well received by attendees and industry.

Conclusion

Australia's superannuation framework, while not by any means perfect, is the envy of many parts of the world, and it has the potential to provide financial security and peace of mind for all of us. However, for it to achieve its promise, we need to ensure that investors in superannuation are both confident and informed by adopting a longer term focus and improving transparency.

Thank you for your time and I am pleased to take any questions.