SUPER SYSTEM REVIEW
FINAL REPORT

CHAPTER 4
Outcomes transparency

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CONTENTS

KEY THEMES

Issue

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.

Proposed solution

The Panel proposes measures, including:

- development by APRA (in consultation with ASIC and the industry) of outcomes reporting standards aimed at standardising the way in which performance and costs are reported;
- a new forward-looking risk and return matrix complemented by disclosure for investment options in a user-friendly 'dashboard' style;
- disclosure by trustees of all costs incurred by the fund, to at least the first non-associated entity level, classified into 'cost categories' for the purpose of benchmarking and improving fund efficiency and performance;
- all past investment return information must be accompanied by information about its volatility and be stated net of all costs and after tax; and
- a government website (www.super.gov.au) to be developed, displaying superannuation information and resources to enable Australians to understand and navigate Australia's superannuation system more effectively.

Benefits for members

Members will benefit from these measures to improve transparency of the superannuation system as:

- increased transparency and disclosure will result in improved understanding for members and, consequently, better decision-making; and
- the new 'forward-looking' investment option disclosure template would enable members to examine possible future performance outcomes, rather than basing investment choices solely on past investment performance information.

1 IMPROVING OUTCOMES TRANSPARENCY

On 16 October 2009, the Panel released its Phase Two: Operations and Efficiency Issues Paper which canvassed a range of issues about fees, costs and disclosure in super funds. These issues went directly to the efficiency with which Australian super funds are being run, a theme central to the terms of reference and work of the Review.

While some of the Phase Two issues are addressed in chapter 9, this chapter focuses on fees, costs and investment returns and how to improve transparency through more meaningful reporting to advisers, researchers, analysts, regulators and, ultimately, to members. The aim of this reporting would be to bring about more comparability, promote the efficient operation of the superannuation market and, ultimately, drive more accountability for member outcomes.

1.1 Current issues

Transparency is critical to the efficiency and operation of a market-based savings system. It improves understanding, awareness and engagement at various levels; not always directly at member level.

The Panel has concluded that the superannuation system lacks transparency, comparability and accountability in relation to costs, fees and investment returns.

The Panel believes that this is due to the following factors:

(a) there are not sufficiently strong incentives for trustees to be transparent about the various outcomes: fees, costs, investment returns, and other aspects that are important to members;

(b) the system has evolved over time from various origins, including the life insurance industry, the UK and US style of funds management, corporate defined benefit plans and the not-for-profit sector, each with different business models and approaches, often making comparability difficult;

(c) outsourcing of many functions has led to an inherent complexity, with fees and charges being incurred at multiple layers;

(d) a cultural and attitudinal barrier to effective disclosure of costs and fees; a belief that it is only the net investment return that matters, without clarity around risk exposure;

(e) disclosure requirements (for example, in Product Disclosure Statements (**PDSs**) have tended to mechanistically reflect existing complexities, which in turn has invited a 'data dump' approach to fee disclosure, quite commonly resulting in too many pages of fee disclosure in PDSs;

(f) there has been a lack of effective enforcement against those who fail to comply with their disclosure obligations; and

(g) the language of debate around data and disclosure has been largely captured by those whom it has suited to characterise members as 'investors' and the purpose of data disclosure as limited to enabling investor choice of fund or investment option.

1.2 New approach

The Panel has concluded that the current model of consumer sovereignty in super, with member autonomy underpinned by complex disclosure, is not optimal. The requirement that disclosure be 'clear, concise and effective' has not worked in superannuation.

MySuper (discussed in chapter 1) represents one element of reframing the model, with sound product design and regulation replacing the need for detailed member-level disclosure.

Other critical elements include:

(a) a requirement to prevent fees and costs from being obscured through use of intermediaries, unnecessarily complicated language and netting of fees from investment returns;

(b) recognition that, in an imperfect market, most disclosure needs to be targeted to member proxies such as independent advisers, regulators, researchers and analysts to enhance competition between funds and sectors; and

(c) information that is given to members being simpler, standardised where necessary (to enable comparability) and being forward-looking.

There should also be a more concerted effort by fund trustees to understand the incurred fees and costs. The Panel believes that a core element of governance is that trustees should be able to demonstrate that they understand all elements of incurred expenditure and can manage the impact of that expenditure on member retirement savings on an after-tax and after-cost basis. This would improve the ability of trustees to provide better transparency of fees and costs outcomes to members.

There are two ways to improve the level of transparency in the super industry: a change of attitude on the part of participants, or a tougher regulatory stance. Given the inability of the industry, however well-intentioned, to arrive at a universally-accepted model, the Panel believes that well-focused regulatory pressure is the best way of ensuring that adequate information is disclosed in a form that is comparable, meaningful and helpful to members, regulators and the industry.

It was recently noted in the media that the industry remains split over proposed changes to the way super fund performance is measured.[1] This supports the Panel's belief, and the views expressed in many submissions, that real changes that will benefit members can only be achieved through regulatory intervention.

2 OUTCOMES REPORTING STANDARDS

The Panel believes that the lack of transparency of outcomes in Australian superannuation can be resolved through a new tool: 'outcomes reporting standards' to be developed by APRA in consultation with ASIC, the industry and other relevant stakeholders. The standards would be developed by APRA under a new standards-making power that the Panel has recommended be given to APRA, as discussed in greater detail in chapter 10.

Improving transparency and outcomes reporting within Australia's complex super system requires fine adjustments. The Panel sees these standards as the best way of achieving tailored solutions to many of the measurement, disclosure and comparability issues affecting the industry. The Panel believes that outcomes reporting standards have the potential to resolve the vast majority of problems identified in this chapter in a way that best suits the needs of stakeholders. They can be the subject of comprehensive consultation and have the flexibility to provide innovative solutions, such as effectively overlaying existing (and unsatisfactory) accounting standards. This is discussed later in section 4.1.

3 INFORMATION PROVIDED BY SUPER FUNDS

3.1 The users of super data

It is not the Panel's position that the average member has a need for a large amount of data about superannuation, but there are a number of stakeholders who need different types of data for a variety of reasons. These stakeholders include:

APRA, which, as part of its prudential supervision of superannuation funds, needs to know that the fund is being operated soundly by the trustee in accordance with its risk management plans, its investment strategies and other trustee policies. APRA uses the data it collects to help risk-rate each fund. Major changes in trend data, or other indicators of increased risk, will lead to earlier and a more intensive on-site review of the trustee's operations, and mitigate (though not eliminate) the risk of member losses due to mismanagement. APRA's use of data in this way is of direct benefit to members. The Panel is now proposing that APRA be given a new mandate; to monitor and regulate the efficiency and outcomes of super funds. This is discussed in more detail in chapter 10.

Employers, who are generally required to choose a default fund for their employees, benefit from the ability to compare how efficiently different funds perform and manage a variety of costs.

Financial advisers, who need to make sound, evidence-based recommendations to their clients, whether individuals, or employers seeking a default fund for their employees.

Government and its policy advisers, who need reliable industry-wide data in order to assess the continuing soundness of policy settings and the need for any adjustments. Reliable data on fund performance after fees and taxes would also provide an essential degree of industry-wide accountability for the $22 billion a year investment the government makes in the super industry by way of tax concessions.

Members, who might wish to compare the performance and cost of their fund (or investment option) with others available to them.

Researchers and commentators, both in Australia and overseas, who use data to analyse the industry, help drive innovation and competition, and improve understanding.

Trustees, that might want to compare and benchmark their fund's performance with the performance of other funds locally and internationally.

3.2 Current sources of information

Trustees are required to provide information directly to members by way of periodic statements. These statements provide useful information on the performance of the member's own account, but form a very limited basis on which to make a comparison with other investment options or make a judgment about the whole of the fund. While members can request a copy of the audited financial statements for the fund, this report is highly aggregated and rarely requested. An annual fund report is also available to members. There are generic requirements for these annual fund reports to include the information that the trustee reasonably believes a member would reasonably need for purposes of understanding the management and financial condition and the investment performance of the fund, and a description of the investment strategy and objectives in respect of the fund.[2] Trustees also provide some financial information about the costs of investment options in PDSs. However, information on costs is often presented in ranges, which diminishes its usefulness. Trustees must also report to APRA and can voluntarily provide data to commercial research houses.

APRA collects data using its powers under the *Financial Sector (Collection of Data) Act 2001* (**FS (CoD) Act**). It uses this data principally for the purpose of its prudential supervision of the industry, but also to fulfil its mission to 'act as the national statistical agency for the Australian financial sector'[3] and to provide data required by the Australian Bureau of Statistics (**ABS**) in preparing the national accounts. To meet the latter purpose, APRA also publishes available data from Exempt Public Sector Superannuation Schemes (**EPSSSs**) and data on SMSFs, which is provided by the ATO. APRA's publication of industry, sectoral and fund level data is therefore not designed, nor intended, to help members select funds, or investment options based on past performance data.

Commercial research houses[4] collect and provide data on investment performance of individual investment options. These data are generally only available to paying subscribers. Additionally, the data suffer from several inherent limitations, such as:

(a) selection bias as the data is submitted voluntarily by trustees. Trustees may avoid submitting data on poorly performing funds, or investment options, to avoid adverse comparisons. The data coverage is therefore incomplete and results are skewed towards better performing funds;

(b) the submitted data on investment performance of individual investment options are calculated by the fund trustees and are unaudited;

(c) data disclosed by trustees are inconsistent, and can require substantial adjustment by the agencies to enable reasonable comparability;[5]

(d) naming of investment options differs across superannuation funds, so obscuring the underlying asset composition and making comparison difficult. Methodologies for performance comparisons also differ across research houses; and

(e) the potential for conflicts of interest as commercial research houses might find it difficult to be objective about a poorly-performing fund that buys other services the research house provides.

4 DEFICIENCIES WITH EXISTING FINANCIAL REPORTING INFORMATION

> *"Financial reporting is a key governance mechanism by which superannuation fund trustees are accountable to fund members and other stakeholders. Apart from highly aggregated information contained in abridged financial reports, information disclosed to members in annual reports is unregulated and generally unaudited. This situation presents scope for trustees to manipulate disclosures, thus potentially misleading fund members and adversely affecting their decisions ... findings reveal a lack of transparency in superannuation fund reporting that limits the usefulness of disclosures as a fund governance mechanism."*[6]

The concern expressed in the quote by two prominent accounting academics is shared by the Panel. The current disclosure position is an inadequate compromise: members get quite complex and often unhelpful information and experts get aggregated and non-specific data.

4.1 Accounting standards

Financial disclosure should play a critical role as a governance mechanism and in improving transparency and comparability. However, despite its importance, the current accounting regime relating to the superannuation system leaves a great deal to be desired.

The accounting standard AAS 25 — Financial Reporting by Superannuation Plans (**AAS 25**) requires only aggregated or 'whole of fund' financial reporting, while the industry and super members are concerned about the performance of the investment option in which they are invested. This is the 'product' that the industry has created and which the members 'consume'. For this reason, financial statements at fund level are rarely used by analysts, researchers or members.

The disconnect between AAS 25 and the financial information that users require is demonstrated by the following examples:

(a) the PDS for the fund must disclose the fees and returns at an investment option level;[7]

(b) member periodic statements must contain information about the investment return applicable to each particular member;[8]

(c) the annual report to members usually contains information relating to the investments, returns and management expense ratios for the various investment options offered by the fund;[9]

(d) the potential for inconsistency of treatment of specific expenses such as the administration expenses — for example, some funds currently follow IFSA Standard 6.00 (which requires administration expenses to be deducted in arriving at net investment returns) while other funds do not;[10]

(e) the potential for trustees to report returns and expense ratios selectively — a long-standing concern as identified in the 2002 Ramsay report to ASIC;[11] and

(f) AAS 25 treats the investment return from a life company that wholly backs a superannuation fund as the proceeds of an insurance policy, and there is no need for the accounts to disclose underlying fees and costs or any other information. This is clearly unsatisfactory and creates a regulatory imbalance between super funds that have access to this structure and those that do not.

While management accounts are typically prepared at the investment option level to enable allocation of earnings and costs to members, it is only the fund financial statements prepared at the whole of fund level that are audited. Other investment vehicles, such as registered managed investment schemes, and even SMSFs, which are significantly smaller than the average investment option in a large APRA fund, require annual audits.

The Australian Accounting Standards Board (**AASB**) has issued an Exposure Draft 179 — Superannuation Plans and Approved Deposit Funds **(ED 179**) to replace AAS 25. While this will modernise an outdated accounting standard and improve whole of fund disclosure, the Panel does not believe that ED 179 will materially improve the information needed by users, in particular members.

4.2 The solution

In this context, the Panel therefore sees the need for outcomes reporting standards (discussed in section 2) that would require trustees to calculate and disclose items such as fees, cost and performance, at MySuper and investment option level, according to a standardised methodology and tailored to the contemporary needs of the industry. These standards would operate as an overlay to AAS 25 and ED 179 for large APRA funds.

The standard methodology would then be applied by trustees of all large APRA funds in the calculation of both investment performance and costs. This would provide interested parties with the ability to make the comparisons they believe are warranted. The regime would have the flexibility to deal with any number of the current transparency and comparability problems affecting the industry.

It its Second Phase One Preliminary Report on MySuper, the Panel said that MySuper would require separate audited financial statements to support transparency and comparability. The Panel's concluded view is that an outcomes reporting standard could produce a better outcome for all stakeholders, but still believes that a level of assurance by way of audit would still be required. The mechanism by which this would occur should be specifically addressed in the relevant outcomes reporting standard.

Recommendation 4.1

With an enhanced rule-making power, APRA, in consultation with ASIC and industry, should develop outcomes reporting standards as an overlay to the existing accounting standards AAS 25 and ED 179 to facilitate consistent and comparable reporting by large APRA funds of investment performance and costs at investment option level, including for MySuper products.

4.2.1 APRA whole of fund reporting

Current APRA performance data reporting is at an aggregated whole of fund level. Many submissions noted problems with this approach; the data have limited comparability and are not necessarily representative of the investment returns of individual investment options. A number of submissions suggested that APRA's publication of whole of fund level data be discontinued. For example, ASFA said that:

> *"The investment performance data published by APRA provides limited assistance in regard to checking the relative performance of superannuation funds. The APRA "whole of fund" return figures, which for each fund show the return for the total of all the different investment options every member has chosen, is of limited relevance to individual consumers."*[12]

As a matter of general principle, the Panel disagrees with this suggestion, even though it sees the limitations in the whole of fund performance data. There is still a community interest in the structure and operation of funds overall. The Panel therefore believes that whole of fund level reporting by APRA should continue with one important change. Whole of fund level reporting by APRA would **not** include APRA-derived fund level performance data (that is, investment return). Instead, the Panel proposes that APRA publish performance data in relation to MySuper products, but not other investment options.

4.3 Investment option level reporting

As at 30 June 2009, the average number of investment options offered by the 121 retail funds was 165, with the median offering being 17.[13] Even though there are many common options and many of these are single-sector options, there are still many distinct investment options to consider. The data collection task would be potentially enormous and organisation and distribution of the data would need to be very efficient.

While the Panel favours the publication of performance data at investment option level, it proposes that investment option performance data, for choice products, be disclosed on fund websites, as opposed to being published by APRA. In addition, this information could be disclosed on the government superannuation website to facilitate comparison across funds. The website is discussed in more detail in section 9 of this chapter. The Panel considers that it would be an unnecessary cost for APRA to publish investment option level data across the industry.

The Panel recognises that enhancing the reporting obligations at investment option level might add a cost to the industry. This is expected to be minimal given that trustees currently have an obligation to calculate returns and costs for each investment option for the member's periodic statement. Additionally, it is necessary to provide effective disclosure to members and stakeholders.

The outcomes reporting standards would detail the reporting requirements at investment option level such that comparable investment option performance reporting could be achieved. As indicated by ASFA:

> *"Fund members need access to investment performance information relevant to their fund and their particular investment option so that they can make educated choices about the fund they are in. If an intended use of the data is so that members and*

prospective members can compare investment performance then it is essential that information be collected at the investment option level."[14]

The Panel agrees with this view, subject to resolving a number of issues of calculation, standardisation and comparability that are dealt with in section 5.

Recommendation 4.2

In addition to whole of fund reporting, APRA should publish investment return performance data for MySuper products.

Recommendation 4.3

All funds should be required to publish on their websites an investment option performance table (as shown in table 4.1 in this chapter) showing investment returns and costs at investment option level, in accordance with an outcomes reporting standard to be developed by APRA in consultation with ASIC and the industry.

4.3.1 Lack of standardisation and consistency

There is a fundamental lack of consistency in the way fund information is calculated and disclosed. The lack of consistency reduces the comparability of information and fund performance.

Chant West recently conducted an exercise where they looked at the information disclosed in PDSs of the 30 largest industry and 30 largest retail funds. They indentified a large number of material differences in how trustees disclosed fees, performance and insurance information, which required Chant West to make 146 adjustments before the information from all funds was comparable. They found that making the adjustments for comparability can make a difference of up to 20 per cent in the disclosed fees.[15]

Some of the reasons why fund information was not comparable were:

(a) costs were reported either before or after tax;

(b) investment returns were reported either before or after tax;

(c) performance fees paid to investment managers were not disclosed;

(d) fees paid to underlying investment managers in fund-of-fund products (for example, hedge funds and private equity) were not disclosed;

(e) member protection costs, particularly in years with low or negative returns, were not disclosed;

(f) investment returns were disclosed where not all costs had been deducted; and

(g) insurance commissions were not disclosed.

While a number of research houses analyse fund performance to improve comparability of information, this leads to extra costs and makes members more dependent on intermediaries. The

Panel believes that standardised reporting, based on a prescribed methodology in an outcomes reporting standard (discussed in section 4.1) would improve the comparability and usability of information that is being directed at members.

4.4 Collecting industry level data

Given the Panel's objective to improve efficiency across the sector, super fund trustees should be required, to the extent possible, to lodge statistical reports with only one public sector agency. The Panel believes that information provided to private sector research houses on a voluntary basis is a matter for trustees' commercial judgment, subject to their fiduciary duties and governing rules.

Additionally, the Panel considers that assessment for taxation purposes is a distinct issue, and does not contemplate that as part of the single reporting process.

APRA currently has a comparative advantage in the collection and publication of superannuation data because:

(a) it must collect data directly from all funds (other than SMSFs and EPSSSs) to fulfil its prudential supervisory role;

(b) both the core financial data and the accuracy of most elements of annual returns are subject to external audit; and

(c) the understanding of the fund by the responsible APRA supervisors gives the opportunity for apparent anomalies to be identified, explained and addressed.

At the same time, the Panel recognises that there are efficiencies for SMSFs and the ATO if the ATO continues to be the primary collector of SMSF data. The ATO should continue to pass SMSF data to APRA for preparation of consolidated industry wide statistics.

In chapter 8, the Panel has recommended that the Government give the ATO a specific mandate to collect and produce SMSF statistics.

Recommendation 4.4

APRA should be the sole public sector agency responsible for collecting data for all public purposes in respect of all APRA funds and EPSSSs. APRA should have the primary responsibility for the publication of all superannuation data in as disaggregated a form as is consistent with privacy principles.

Recommendation 4.5

The ATO should continue to collect data in relation to SMSFs.

5 STANDARDISING INVESTMENT OPTION INFORMATION

5.1 Standardisation of disclosure

The lack of standardisation in preparing and disclosing data reduces comparability and transparency in the superannuation industry. Chant West expressed the view that:

> *"The super disclosure regime is a mishmash of statutory requirements, some of which are open to selective interpretation, and unenforceable 'guidelines' which individual funds either follow or not depending on whether it suits them."*[16]

The Panel agrees with this view and believes that standardisation, by way of flexible outcomes reporting standards that can keep up with industry changes, is of paramount importance in achieving a more efficient super system.

5.2 Investment option labelling

Investment options offered by super funds are often identified by labels such as 'balanced', 'growth', 'capital stable' and the like. Currently, these labels have no standard meaning, resulting in reduced comparability. For example, some 'balanced' investment options have 80 per cent of so-called 'growth' assets, while others have as little as 60 per cent. Apart from anything else, existing investment option descriptions do not allow members to make informed decisions because they provide inadequate information about the expected returns and volatility of various investment options.

The Panel does not believe that it would be feasible to mandate asset types and allocation ranges within the existing nomenclature or that it would be desirable to impose that level of rigidity on products. The Panel instead favours the introduction of a risk and return targeting framework in the formulation, disclosure and measurement of investment options and their performance. This is discussed in section 6.2.

5.3 Disclosure of investment option volatility (risk)

The Panel believes that members overestimate the likelihood that past performance will persist. This leads to inappropriate decision-making and is a cause for concern. A substantial amount of the advertising in the industry is based on explicit and implicit representations about past performance.

United States research house DALBAR has conducted a number of studies showing how individual investors earn much lower net investment returns than the headline returns of the funds they invest in. This is because investors often chase past performance by switching funds or investment options, often at an inappropriate time and overlooking tax and transaction costs. For example, quantitative analysis of investor behaviour performed by Dalbar Research in 2005 showed that over the 20 years from 1986 to 2005, the average investor in a US equity mutual fund earned 3.9 per cent compounded annually before tax. Over the same period, equity mutual funds reported average earnings of 9.3 per cent annually. US inflation over the period averaged 3.0 per cent per annum.[17]

The Panel considers that members should be made more aware of the likelihood of variance from past performance. It should be mandatory for trustees to disclose a standardised measure of the uncertainty or volatility associated with the return when quoting past investment option or MySuper product performance. This would enable advisers and, in time, a growing number of members to examine the theoretical likelihood of achieving a similar level of performance in subsequent periods.

This view was also supported by ASFA which indicated that the provision of an indication of risk and volatility "*will have potential benefits for fund members …* [but] *there has been a lack of progress made by the industry on this issue to-date*."[18] This supports the Panel's conclusion that tailored regulatory intervention is the most appropriate mechanism to achieve necessary change in the industry.

The Panel believes this risk measure would need to be developed in consultation with industry but, by way of example, it could be based on the number of quarters with negative investment returns for a particular investment option over 10 years, that is, 40 quarters. Trustees would then be required to disclose this measure when quoting past investment returns, as is shown table 4.1 in section 5.6 of this chapter.

The Panel notes that, as part of these proposals, new funds or investment options would not have sufficient data with which to calculate volatility against 10-year returns. The Panel believes that this issue would need to be considered as part of the development of an outcomes reporting standard, specifically addressing how an adequate measure of volatility could be disclosed for newly established funds or investment options. One possibility could be to require that trustees offering options with less than 10 years of investment returns would supplement the actual history of the option with a measure calculated by APRA to publish a fair indication of volatility over a 10-year period.

Recommendation 4.6

It should be mandatory, when referring to past performance of a MySuper product or a choice investment option, to disclose a standardised measure of the uncertainty or volatility associated with the return (an example of which is shown in table 4.1 in chapter 4). This requirement, and the volatility measure to be used, should be in an outcomes reporting standard to developed by APRA in consultation with ASIC and the industry.

5.4 Explaining costs on a pre-tax basis

Explaining costs to members on a notional after-tax basis (that is, so that a $100 cost is shown as $85) is confusing. It reduces comparability, as most superannuation funds use gross or pre-tax costs when communicating with members. Referring to costs on a gross basis should be required by an outcomes reporting standard.

Recommendation 4.7

All forms of cost and fee disclosure by superannuation funds should be on a pre-tax basis, that is, gross of tax, in accordance with an outcomes reporting standard to be developed by APRA in consultation with ASIC and the industry.

5.5 Reporting of net investment returns

Super funds are currently able to report their investment returns either before (gross) or after (net of) tax and certain costs. This leads to reduced transparency and comparability between funds and is unhelpful for members. To mitigate this confusion, a number of submissions suggested the adoption of standardised reporting of performance on a net basis, that is, net of all costs and taxes. For example, ASFA recommended that after-tax returns "*should … form part of a reporting standard*."[19] Morningstar also believes that there should be a regulatory standard for after-tax reporting.[20]

There were other submissions that argued that disclosure of after-tax returns was unnecessary. For example, AIST suggested that "*trustees appropriately balance tax and investment aspects in their overall investment strategy and operations. As such we do not believe there should be any major reforms in this area.*"[21]

Different approaches to investment return disclosure are found across the industry. In some cases, fund and member administration costs are not taken into account as part of the investment return calculations or in the subsequent disclosure of investment returns. Other funds treat such expenses as part of generating the net investment return. This lack of consistency is obviously highly unsatisfactory.

The Panel notes the commencement of IFSA's standard 6B, intended to apply to its membership on a phased basis starting from 1 July 2010, with full implementation from 1 July 2012.[22] However, in contrast to the approach currently required of IFSA members (and already generally adopted by industry), the new IFSA standard proposes that returns be reported net of tax and investment fees, but gross of administration, contribution, withdrawal and advice fees.

Given that member benefits can only be received on an after-tax basis and after all costs are paid, it is illogical and misleading for investment returns to be reported to members on anything other than an after-tax basis and after all costs have been deducted. Before-tax reporting allows investment managers and trustees to take less care in managing the consequences of their investing style (discussed further in chapter 3). At the same time, revealing gross returns with tax and costs to give the net return allows members and other stakeholders to analyse how costs and tax are managed. Standardised reporting showing both gross and net investment returns on an after-tax and after-cost basis would ensure greater transparency and accountability. A submission from CPA Australia also suggested that:

> *"mandating the reporting of after-tax investment returns would also assist members to better understand the performance of their superannuation funds and be able to properly compare the investments of different superannuation funds."*[23]

Since 2001, the U.S. Securities and Exchange Commission has required mutual funds to disclose in their prospectuses, advertisements and other sales materials after-tax returns based on standardised formulae.[24] The Panel supports a similar approach being adopted and believes that APRA needs to develop an outcomes reporting standard for after-tax and after-cost reporting of investment returns.

Recommendation 4.8

An outcomes reporting standard should be developed by APRA, after consultation with ASIC and the industry, which would deal with how investment returns have to be calculated both gross and net of all costs (administration and investment) and taxes and then disclosed only in a format governed by the standard.

5.6 Disclosure of investment option performance

The Panel believes that trustees should disclose performance data for each MySuper product and choice investment option in the format shown below in table 4.1. An outcomes reporting standard to be developed by APRA, in consultation with ASIC and industry, would detail how this table would have to be presented, including the requirement to report:

(a) gross investment returns for the investment option for 1, 5 and 10-year periods;

(b) costs (investment and other) on a pre-tax basis for 1, 5 and 10-year periods;

(c) investment returns net of all costs (administration and investment) and taxes for 1, 5 and 10-year periods; and

(d) the number of negative quarters of investment returns the investment option has incurred in the past 10 years (as discussed in section 5.3).

The Panel believes that to improve comparability, all figures should be quoted as a percentage of average assets held in the option over the reporting period, and not in dollar figures.

The Panel believes that the information in this table should be available to members for as long as the fund remains in existence (that is, beyond 10 years). The historical information should be easily accessible to members and non-members on the fund's website. This would enable members and industry to monitor the performance of a particular investment option over time.

The investment option performance table should be produced on an annual basis in line with the fund's balance date. The Panel believes that the timing of disclosure of investment option performance should be stipulated in an outcomes reporting standard.

As indicated by a submission by the Association of Independent Retirees (AIR):

> *" … additional contributions from employment, either at the superannuation guarantee level or as voluntary contributions, attract contributions tax at the rate of 15%. This tax is separate from the tax liability of the earnings on assets, which also attracts tax at the rate of 15% when the assets are held in the accumulation phase. In the drawdown phase, provided the requirements of the regulations are met, there is no tax liability on earnings on assets in the fund or on the pension paid. Furthermore, earnings from employment above the age of 75 do not attract employer contributions tax except under certain special circumstances."*[25]

Consequently, the Panel believes that taxation information relating to contributions tax and investment earnings should be separated, as shown below in table 4.1.

The proposed method (because it covers single, 5 and 10-year return reporting) has the potential to replace some existing disclosure requirements.

Table 4.1: A sample MySuper or choice investment option performance table

Investment Option: Blue Investment Option			
	Investment return information		
	10 Years	5 Years	1 Year
Gross investment return			A%
Less investment costs			B%
Net investment return (before all other costs and taxes)			C%
Less administration/operating costs			D%
Less net investment-related taxes			E%
Less net contributions tax			F%
Net return (after all costs and taxes)			**G%**
Number of quarters of negative investment returns in past 10 years		**Number of negative quarters/40**	

Recommendation 4.9

In consultation with industry, government should finalise the details of an investment option performance table for MySuper products and choice investment options, building on the model proposed by the Panel. APRA should then specify this in an outcomes reporting standard. Specifically, the consultation would progress the development of a standardised disclosure format containing:

(a) gross investment returns, costs and investment returns net of all costs (administration and investment) and taxes for investment options for 1, 5, and 10-year periods; and

(b) the number of quarters of negative investment returns the investment option has incurred in the past 10 years, or a proxy figure developed using data published by APRA for those options with a history of less than 10 years.

Recommendation 4.10

Investment option performance table data would have to be maintained by trustees and be easily accessible on the fund's website for as long as the fund remains in existence.

6 A NEW APPROACH — A PRODUCT DASHBOARD

The broad effect of the SIS Act and SIS Regulations is to require a trustee to explain the investment objectives of the strategies offered and to provide information for the purposes of the member understanding the risk involved in each strategy.[26] However, in practice, the quality and usefulness of the disclosure is limited, resulting in a lack of trustee accountability on the performance of investment options. There is need for improvement.

The Panel believes that information about the investment strategies of MySuper products and choice investment options should be displayed in a simple, plain-English 'product dashboard'. The product 'dashboard' would not substitute for a fuller description of the investment strategy or option by the trustee as may be required, that is, the 'dashboard' would not replace the PDS (including the new short-form PDS)[27] or the equivalent on-line disclosure material developed for MySuper products.

This standardised methodology would be mandatory wherever a trustee discloses investment option information, whether in a PDS, advertising material or online.

6.1 Squam Lake Working Group standardised disclosure model

The Panel's proposed model is similar to one proposed separately in the United States by the Squam Lake Working Group on Financial Regulation (**SLWG**) in its 2009 paper titled '*Regulation of Retirement Saving*'.[28] The ideas proposed by the SLWG resonated with the Panel because they aligned with its thinking. The SLWG consists of 15 prominent academics, from various academic institutions,[29] who offer guidance on the reform of financial regulation in the United States.

The SLWG propose a standardised disclosure 'label' to encourage comparison-shopping on important attributes and to provide meaningful information about the cost and risk of the investment that would help decision-making.

The SLWG model addresses fees, a range of 'payout' scenarios over an appropriate investment horizon, the annual risk of negative return and the portfolio turnover or 'churn' ratio within the option. The model is reproduced in appendix 1 of this chapter. The Panel is attracted to the SLWG model, particularly given that it does not include any element of past performance as a relevant consideration. The Panel believes that a model like this could provide fund members with suitable information to assess the fees, risks and returns of an investment strategy or option without relying on past performance.

6.2 Risk and return targeting

The Panel suggests that trustees, in devising diversified investment strategies, focus on the investment return objective and level of risk, rather than on the asset class exposure for the particular investment strategy or option. This could be called 'risk and return targeting'. Some of the benefits of this approach would include:

(a) trustees would be responsible for managing the total investment risk of the diversified investment option, rather than focusing on the management of asset allocation benchmarks. This would emphasise the significant responsibilities of trustees in identifying and managing investment risk on behalf of members, particularly in MySuper products;

(b) trustees would have greater flexibility to adjust their asset allocations in changing market conditions in order to maintain their targeted risk/return balance, avoiding their portfolios being anchored to portfolio weightings that have been overtaken by market circumstances;

(c) it would leave the detail of the asset allocation in the hands of the trustees, who are best placed to understand the needs and attitudes of members, with the member simply identifying their risk and return preference (if any); and

(d) a risk-targeting framework is forward-looking while the current performance information is backward-looking and does not provide members with a proper indication of expected future returns. Disclosing forward-looking information would help manage member expectations by highlighting the potential volatility of a particular strategy.

A submission from David Bell of St Davids Rd Advisory also argued for a risk-targeting approach to replace products defined by generic asset allocation rules. He argued that enforcing a risk-targeting approach would make funds more accountable for the risk they take and the return they deliver for that risk. Specifically, the submission recommended:

> *"Shift to a risk targeting framework. This would replace the concept of asset mix defined products. The onus for risk and return would be placed firmly in the hands of the investment managers of the super fund (where it belongs). This would force the industry to implement substantial improvements to risk management practices (and I believe substantial improvements are required). Investors would also have a better understanding of how much risk they are taking."*[30]

The Panel agrees with these views.

Risk and return are fundamentally correlated (which is the essence of the risk and return targeting idea). Without being able to assess their risk exposure, fund members cannot properly know whether the published investment return is reasonable in the circumstances. Rice Warner Actuaries submitted that trustees should state their investment risks in a standard form and the Panel also agrees with this view.[31]

The investment returns that markets provide over any period are unpredictable, but the volatilities of investment returns are much more manageable if the trustee has a greater flexibility in asset allocations. Accordingly, the Panel considers that diversified investment options should be classified according to risk and return categories. These could be expressed in many different ways; for example, a return of 'CPI + 4 per cent' over a particular period, with risk indicated by a return volatility or the probability of a negative return in any year or period of years.

For the purposes of the proposed product 'dashboard' (see section 6.2.2), the Panel believes that the level of investment return targeted by each investment strategy or option should be expressed as an annual percentage rate above inflation, over a rolling 10-year period. This could be displayed as a set of standard ranges of return above CPI as stipulated in the outcomes reporting standard. This would be developed by APRA in consultation with industry. The Panel considers that this projection of real return, accompanied by the requirement to deal with investment returns on a wholly net basis, would be most relevant to super fund members. Of course, some funds already communicate to their members the expected long-term real returns of their investment options.[32]

For the purposes of the proposed 'dashboard' disclosure, the Panel is attracted to the general concept of the 'possible 10-year payoffs' in the SLWG model (see appendix 1). The Panel envisages trustees would detail the potential performance of the investment for a set amount, and in a range of scenarios. This representation of the risk associated with the investment option could be expressed in a visual, 'box plot,' format. This would enable the member to see the potential range of outcomes for an investment option given the aim and cost of that option (cost is discussed further in section 6.2.1).

In designing their investment options, trustees should have a number of bases (for example, historical data, assumptions, expert opinions and other evidence) to support the objectives they propose to present to members.

Under the risk and return targeting approach, each trustee would be more accountable to members and also, ultimately to the regulator, for the reasonableness of its assessment of the return and risk assumptions of its various investment options. Non-trivial or prolonged deviation from the trustee's disclosed objectives would be cause for investigation and, if appropriate, proportionate action by the regulator. This would likely lead to more intensive supervision and public disclosure of the deviation and the reasons for it. In severe cases, it might lead to the forced withdrawal of the investment option due to the trustee's incapacity to manage it appropriately.

Risk targeting could only be achieved within diversified investment options as opposed to undiversified options. Undiversified option labels typically refer to the underlying assets in the option. Consequently, any 'risk and return targeting' in such an option would result in changing those assets, making the option no longer true to label. For example, if an investment option only contained unhedged overseas equities, an attempt to target risk and return within this option would likely result in the need to replace some of the unhedged overseas equities with other assets. With respect to an undiversified investment option, the Panel proposes that the trustee should clearly indicate that the option is not diversified by expressly disclosing the underlying asset(s) of that option.

6.2.1 Product 'dashboard' — fees and costs

The investment fees and costs component of the product 'dashboard' is an aspect distinct from the presentation of the objective and risk of the investment strategy or option.

The SLWG concluded that:

> *"fees above a threshold should trigger a warning about the long-term consequences of high fees, analogous to the surgeon general's warning on a package of cigarettes."*[33]

This proposition is very similar to the 'traffic light' question the Panel posed in its Phase Two Issues Paper.

Many submissions argued that high investment fees can be justified where the fund achieves higher performance. However, no data has been provided to the Panel that supported the assertion that higher fees either across the industry (or for an equivalent asset allocation and risk exposure) correlated in any meaningful way with higher long term investment returns. In fact, most research contradicts this view.[34] The impact of investment costs can be damaging to the members' net return and subsequently the members' retirement benefit. This is why the SLWG proposed including the above warning.

The Panel favours a peer-ranking approach where the 'dashboard' would show, via a simple dollar sign graphic, which fee quartile the option fell into when compared to all others with the same objective. APRA would collect and publish the fee quartile data. Four dollar signs would signify the most expensive quartile and one dollar sign the least expensive quartile.

Additionally, the Panel believes that a useful comparison tool for members is comparing the projected Total Annual Expense Ratio (**TAER**) to the investment objective and projected 10-year outcome. The TAER is a new expense ratio, recommended by the Panel, that captures **all** the investment and administration expenses of a MySuper product or choice investment option to at least the first non-associated entity level, as calculated according to an outcomes reporting standard.

While the TAER would typically be historical, for the purposes of the 'dashboard', this ratio would be forward-looking (that is, trustees would forecast a TAER based on historical data and predicted results). The Panel believes that using TAER, instead of only those fees charged directly to members, could be equally useful for members to compare the ability of trustees to manage costs against projections. Consequently, the Panel believes that trustees should publish the historical TAER on the fund website and the forecast TAER on the investment option 'dashboard' (see section 6.2.2). The historical TAER is discussed further in section 8.3.2.

6.2.2 Sample product 'dashboard'

Despite developing an example standardised disclosure label, the SLWG recommended that the form and specifications should be developed by a "*committee of academics, regulators and industry experts*."[35] The Panel proposes a similar approach, but again starting from a fairly concrete conception of what the 'dashboard' is intended to achieve and what it should contain.

Building on what has been discussed in previous sections, the Panel believes that the following issues would need to be covered in a simple visual format:

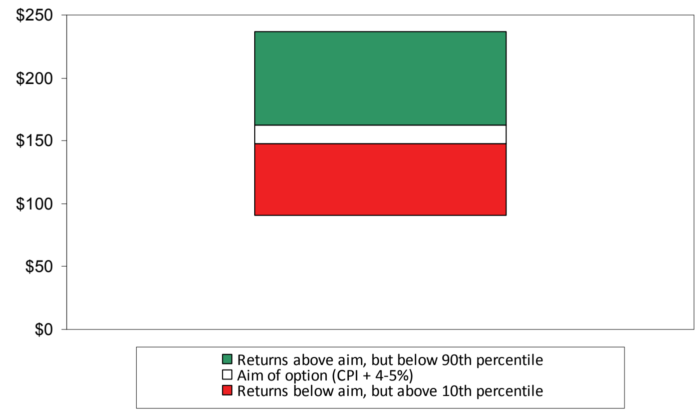
(a) the investment return target in putting forward a particular investment strategy or option;

(b) the risk target or range of possible outcomes of the strategy or option; and

(c) the projected TAER in relation to that strategy or option and its projected liquidity.

The information identified by the Panel above could be displayed as set out below in the following figure diagram.

Figure 4.1: A sample product 'dashboard'

<table>
<tr><th colspan="2">XYZ Blue MySuper</th></tr>
<tr><td>Type of option</td><td>MySuper</td></tr>
<tr><td>Investment return target</td><td>CPI + 4-5% over rolling 10-years</td></tr>
<tr><td>Risk target — range of possible 10-year outcomes (per $100)</td><td>
</td></tr>
<tr><td>Projected liquidity</td><td>High</td></tr>
<tr><td>Projected TAER</td><td>1.21%</td></tr>
<tr><td>Relative fees ranking</td><td>$$ out of $$$$</td></tr>
</table>

Note: The figures used in the above product 'dashboard' are purely illustrative and do not reflect the characteristics of an actual investment option.

The 'dashboard' would be supported by the following explanations:

(a) **Type of option** describes whether it is a MySuper product or choice investment option;

(b) **Investment return target** describes the real return the trustee will try to achieve for this investment option. This would be expressed on a real basis and net of fees, costs and taxes;

(c) **Risk target — range of possible 10-year outcomes** describes the range of possible outcomes if you invest $100 in this option over 10 years. This would be expressed on a net basis (that is, after fees, costs and taxes). The Panel believes that the range of possible 10-year outcomes in the 'dashboard' should be presented in today's dollars that is, discounted by CPI. Present-day values provide more meaningful information to members as opposed to future dollar values, which can give an unrealistic representation of increased purchasing power. The value of the final (inflation-adjusted) outcome for the investment:

i. has a 10 per cent chance of being below the red box;

ii. has an 80 per cent chance of being within the green, white or red boxes;

iii. is represented by the white box if the option performs according to its aim;

iv. has a 10 per cent chance of being above green box; or

v. can be even more extreme than the range of outcomes depicted.

(d) **Projected liquidity** would indicate whether or not the option was outside the normal 30-day portability rules by classifying the option according to the degree of liquidity, that is, high, medium or low. The Panel believes this is a key disclosure for members in understanding the implications of investing in the option. This measure would be developed through industry consultation and the development of an outcomes reporting standard;

(e) **Projected TAER** is the projected TAER for the investment option of the MySuper or choice fund. The projected TAER captures all the forecast expenses (that is, investment and administration costs) of the option. This projected figure would enable members to compare the forecast expense ratio with the historical TAER achieved by the investment option; and

(f) **Relative fees ranking** ranks the fees charged for investing in this option compared to all other options with the same aim. The number of dollar signs shows that the option is in the lowest, second, third or highest fee group for options that have the same aim. This would be expressed on a gross basis (that is, before tax). The Panel believes that the issues associated with ranking of fees should be determined in consultation with industry.

The 'dashboard' would also need more general explanatory notes about what it aimed to do, the relative significance of each piece of information and its overall limitations.

Recommendation 4.11

Trustees of large APRA funds should disclose each diversified investment option's investment return target and risk target, as shown in Figure 4.1 of chapter 4 in a product 'dashboard'. A similar approach should be required for undiversified options, with the underlying asset class or classes being disclosed in place of the 'investment return target'.

Recommendation 4.12

In consultation with industry, APRA should develop an outcomes reporting standard dealing with all of the requirements for the product 'dashboard'. Specifically, the consultation should progress the development of a product 'dashboard' containing the:

(a) net investment return target (after-tax), which should be expressed as a percentage above CPI, over a rolling 10-year period;

(b) range of possible outcomes for a MySuper product or choice investment option (that is, risk target) over a 10-year period in a visual, diagrammatic format;

(c) the projected liquidity of the MySuper product or investment option;

(d) projected Total Annual Expense Ratio (TAER) which would capture all the projected costs to at least the first non-associated entity level; and

(e) relative ranking of overall fees (as collected and published by APRA).

7 REPORTING TO APRA

The Panel recognises that information to a fairly detailed level is already disclosed to APRA under the FS (COD) Act through the APRA annual and quarterly returns.[36] These returns capture details on a variety of fund operations such as financial performance, financial position, derivative financial instruments, transactions with associated parties, and membership and superannuation entity profile. Quarterly returns are not audited, while some of the annual returns are audited.

These APRA returns contain more detail than the audited financial statements. Even so, many costs are not disclosed or are disclosed only in highly aggregated form. This problem can arise because some of the costs are incurred in 'downstream' entities, rather than in the fund itself. This typically occurs when the trustee owns a subsidiary administrator that provides all services for the trustee as well as the fund; where the trustee is itself owned by an administrator; or where all investment services for the fund are provided by a third party, whether or not that third party is related to the trustee. Another shortcoming is that some of the data is not publicly reported by APRA for confidentiality reasons.

7.1 Standardising the way in which costs are reported to APRA

The Panel proposes that specific superannuation 'cost categories' be developed and reported to APRA. Reporting costs in a limited number of defined 'cost categories' will enhance transparency and comparability between funds, assisting APRA in fulfilling its new mandate to monitor and regulate the efficiency of superannuation funds (discussed in chapter 10).

Superannuation costs would be separated into seven categories, based on the major functions of a typical super fund. These categories, set out below in table 4.2, would capture both explicit and identifiable implicit costs in relation to functions that the superannuation fund must report on. This data would typically be sourced from the management accounts of the fund and must include costs to at least the first non-associated entity level.

Table 4.2: Proposed cost categories

Proposed Cost Categories
Administration
Advice and distribution
Corporate overhead
Investment management
Legal and compliance
Member insurance
Taxation

Set out in appendix 2 in this chapter is a non-definitive list of example costs that would be reportable within the various cost categories.

Under the outcomes reporting standard, funds would not be able to aggregate or net fund costs off against investment returns. Each cost incurred by the fund would have to be properly allocated to the defined 'cost category' on a look-through basis. This would ensure, for example, that fund costs such as advertising could not be shown as 'membership subscription' costs.

A particular advantage of this approach is that it would provide neutrality of reporting of costs and returns, irrespective of whether an asset were held directly by the trustee, through an investment manager, or in a collective investment vehicle. It would also enable trustees to benchmark their performance with other super funds, and analysts to more readily compare funds and sectors.

Recommendation 4.13

As part of the development of an outcomes reporting standard, APRA, in consultation with the industry, would ensure trustees report costs to APRA on a consistent basis. The standard would prescribe:

(a) cost categories and their composition;

(b) requirement for cost categories to be subject to an annual audit;

(c) 'cost categories' to be reported in the APRA annual return at the whole of fund and MySuper levels; and

(d) costs to be disclosed to at least the first non-associated entity level.

7.2 Benchmarking

To drive the advantages of MySuper, the Panel believes that products should be regularly benchmarked against each other according to a transparent methodology, applied on a consistent and objective basis. The Panel believes that benchmarking for MySuper products would specifically enable trustees to:

- measure their costs and fees incurred against peers;
- determine which funds have 'best practice' in specific functions; and
- identify areas for improvement by gaining a better understanding of the fund's strengths and weaknesses.

Ultimately, this would lead to improved decision-making by trustees, regulators, government and members.

The benefits of benchmarking in superannuation were alluded to in a submission from ASFA, which said that:

> *"It is important for trustees to be able to benchmark themselves against other funds in terms of the underlying cost (and therefore the efficiency) of their operations and services. This will allow them to target areas for improvement and over time continually refine their operations to reduce their costs. This information will be used by trustees for operational improvement purposes rather than being released to members (who are more interested in fees and net investment returns)."*[37]

The Panel considers that this benchmarking is best achieved by APRA putting the work out to tender for industry experts to conduct. This approach creates a separation between the regulator mandated to administer the regime and the expert tasked with measuring how efficiently the participants are operating. Naturally, confidentiality and the potential for conflicts with other roles carried out by the experts would have to be addressed.

APRA could then examine the results of this survey to assist in carrying out its new mandate to improve the efficiency of the superannuation system.

Benchmarking could also address MySuper trustees' duty regarding scale. The Panel has proposed that MySuper trustees would have to demonstrate, on an annual basis, that they have sufficient scale in order to deliver optimal benefits to members. By benchmarking the MySuper product trustees could have an objective measure to assist in determining whether it had sufficient scale.

Recommendation 4.14

Trustees offering MySuper products should be required to participate in APRA-approved benchmarking surveys that would measure their relative efficiency against peers in a number of key areas (for example, administration costs per member, service standards) in accordance with an outcomes reporting standard to be developed by APRA in consultation with ASIC and the industry. APRA should be required to publish the results of such benchmarking surveys.

7.3 Asset allocation

Asset allocation is a significant determinant of returns, volatility and exposure to risk. However, where trustees have invested through collective vehicles such as life policies or pooled superannuation trusts, there is difficulty in determining the actual underlying asset allocations. APRA has proposed collecting asset allocation data on a 'look-through' basis whereby a trustee would report the assets underlying its collective investments to at least the 'first non-associated entity level'.[38] This would help analysts in calculating rates of return that have been adjusted for the risk of the underlying asset allocation. Asset allocation data are required in any event so that the trustee can be satisfied that the fund remains within its investment strategy risk-band. Information at the whole of fund level would still be needed in order to satisfy ABS requirements.

Recommendation 4.15

APRA should have explicit powers to collect superannuation fund data on a 'look-through' basis so that it can achieve an understanding of the fund's asset allocation, risk, returns and costs.

7.4 Disclosure of portfolio holdings

Trustees are currently required by the Corporations Act to provide fund members, in the annual report to members, with details of each investment, or each combination of investments in a group of associated enterprises, that has a value in excess of 5 per cent of total assets.[39]

A trustee is also already required to make available, on request and free of charge to a member, information reasonably required for the purposes of making an informed judgment about investment performance and to understand the particular investments of the fund.[40] Trustees are not required to make any other public disclosure about the underlying portfolio investments of the fund.

A Morningstar study of global fund investor experiences found that Australia and New Zealand were the only countries among the 16 assessed which do not require regular, full portfolio holdings disclosure.[41] Australia clearly lags global best practice in this area and the current regime is unduly opaque.

In the United States, investment companies provide quarterly disclosure of their portfolio holdings within 60 days after the close of each quarter.[42] As Morningstar submitted to the Review,[43] this practice has a number of advantages:

(a) It would create an information platform that would promotes better analysis of super funds;

(b) Implementation would create an alignment with global practice;

(c) It would allow interested members to minimise overlap with their non-super investments;

(d) It would provide much greater transparency without significant cost or externalities;

(e) The level of illiquid assets in a portfolio would be more observable;

(f) It would not facilitate front-running (a common argument against this sort of transparency) because (as in the US) there would be up to a 60-day time lag before the information needs to be provided to APRA;

(g) It would discourage undesirable manager behaviour like excess turnover; and

(h) It would enable better monitoring of 'true-to-label' issues.

The practice would have to be principles-based so that it was not hindered by complex ownership structures, life office holdings, intermediate entities and so that it gave a true picture of the overall composition and risk of the portfolio (including overlays, hedging, derivatives and so on). The obligation on the trustee would be to disclose details of the underlying portfolio that would be reasonably required by a professional adviser in understanding the nature and extent of the investments and the exposures involved.

Recommendation 4.16

Trustees of large APRA funds should be required to disclose their complete portfolio holdings on a six-monthly basis in accordance with an outcomes reporting standard to be developed by APRA in consultation with ASIC and the industry. This would require disclosure to APRA within 60 days after the end of each six month period, corresponding with normal financial years and half-years, and then public disclosure of the same information, on the fund's website, three months later.

8 SYSTEMIC TRANSPARENCY

8.1 A new direction in transparency

Many submissions asserted that information about super funds did not need to be disclosed because it would be of no benefit to members: either because it would be confusing for them; or because members generally do not ask for, or read, such information. The Panel strongly disagrees with these views.

The Panel does not expect ordinary Australians to be investment experts or to read complex information about their super. However, in financial markets, there is a great deal of benefit in what could be termed 'systemic transparency': that is, disclosure and information available to the system at large, including to regulators, academics, analysts, advisers and informed investors.

'Systemic transparency' is what is largely missing in the Australian super system. There is too little high quality information available to experts who would be able to use such information for the ultimate benefit of members as a whole. Systemic transparency of information about large APRA funds would sit alongside specific member-focused and event-driven disclosure obligations.

It is not to the point that a trustee might think that the average member is not interested in reading the material. While this is likely to be the case, the Panel considers there are other benefits flowing from the low-cost transparency afforded by the availability of information on a fund's website.

Trustees are already generally required to make available — free of charge and on request by fund members — many documents, including the fund's governing rules and the most recent fund audited financial report; and fund actuarial report (if applicable).[44] However, the Panel considers it is unduly restrictive for members to have to request this information and sub-optimal for the industry as a whole that the information is only available to members. There appears to be no reason why documents and information must first be requested before they can be accessed (given that trustees have to then provide that information), and why this material should not be routinely published by trustees on the fund's website as an aid to systemic transparency. These restrictive and un-transparent settings have reached their 'use-by date'.

The Panel believes that information about a fund made available on the fund's website should be freely available to members and non-members alike. 'Members only' sections of a fund website should be kept to an absolute minimum where privacy and confidentiality considerations, including in relation to members' personal information, would legally require the trustee to restrict access.

The Panel considers that there needs to be a low-cost, but dramatic change in this area. This is where large APRA funds must see themselves as different from other businesses. Given that superannuation is a heavily tax-subsidised 'public good', trustees of superannuation funds must get used to being more transparent about their funds.[45] The Panel therefore believes that there should be new standards for web-based systemic transparency for all large APRA funds.

8.2 Publication on fund websites

The Panel considers that the appropriate vehicle for systemic transparency by a large APRA fund is the fund's own website. The Panel believes that the trustees of large APRA funds should be required to maintain a website to publish systemic information about the fund of at least the kinds discussed below. The Panel's view was supported by the ICAA which submitted that:

> *"The vast majority of fund information including those that satisfy disclosure obligations can and should be made available on fund websites. Documents should only be made available in printed format at the request of members. This would hold significant savings in time and costs for superannuation funds as well as meet increasing environmental expectations of the larger community. When superannuation funds send member statements, they can refer members to the website and advise them that printed copies of documentation are available on request. We don't believe the provision of information in this manner requires the approval of members and seeking approval will simply add another layer of cost. Internet access and the use of the internet are accepted as common usage and should not be viewed as being any different from regular post for the dissemination of information. This could be further enhanced by the use of email to deliver member statements. The ability to contact members via email may also assist in tracking members and reducing lost member accounts.*
>
> *The provision of information in this manner is another way in which administrative cost savings can be achieved for superannuation funds which presumably will be passed on to members."*[46]

Many funds already have in place well-developed websites that make available a range of fund information. The Panel considers that the marginal cost of each additional website disclosures is negligible.

The Panel believes that trustees of MySuper and choice products should retain and make available to members systemic information about the fund over at least the preceding 10-year period, or since inception if the fund is less than 10-years old. This should be easily accessible by members and non-members alike on the fund's website.

The Panel also believes that failure to comply with systemic transparency requirements, outlined below, should be backed up by strong sanctions.

8.2.1 Fund documents

Basic fund structural information should be made transparent on the website, including at least the following fund documents:

- the governing rules of the fund, such as the trust deed and all supplemental and amending deeds and consolidations or extracts/subsets of a fund's governing rules relevant to particular classes of members;
- the most recent audited accounts for the fund as an entity, and for any MySuper product, together with the auditor's report in relation to those accounts;
- the most recent actuarial report on the fund (if applicable) and any subsequent, written advice by an actuary to a trustee to the extent that those documents are relevant to the overall financial position of the fund; and
- the fund's most recent six-monthly statement of portfolio holdings disclosed to APRA to be published three months after disclosure to APRA.

8.2.2 Disclosure documents

All disclosure documents would have to be available on the website including, but not limited to:

- the most recent PDS issued by the trustee with respect to the fund, and an archive of PDSs over the previous 10 years, including supplementary PDSs;
- the most recent annual fund report to members;
- the most recent trustees financial services guide (if applicable); and
- each significant event or material change notification as made by the trustee to fund members or any group of fund members.

8.2.3 Other participants in the fund's operation

The website would have to contain details of the parties who perform the functions listed below in table 4.3 in relation to the fund.

Table 4.3: Proposed fund disclosure functions

Proposed fund disclosure functions
Fund administration
External audit
Internal audit (if applicable)
Fund actuarial services (if applicable)
Investment management
Investment related consulting
Asset custody
Insurance
Legal and tax advice (if engaged on a retainer)

8.2.4 Trustee information

In relation to the trustee, the website would have to contain at least the following:

- the name of the corporate trustee and each person involved in the trusteeship of the fund including, as relevant, each director of a single corporate trustee or individual trustee in a group of individual trustees and any alternates;
- relevant experience and background of each director or individual trustee and any alternates;
- a description of the role of each person above, including, as relevant, the status of each person above as an employer or employee representative director or additional independent director and service on any trustee subcommittee; and
- the fund's procedures for the appointment and removal of the trustee and each director of a corporate trustee, or individual as a member of a group of trustees.

8.2.5 Board and executive remuneration

In relation to the trustee and executive, the fund website would have to contain at least:

- the trustee's remuneration policy in relation to both the trustee-directors and executives of the trustee; and
- remuneration details similar to that required for major listed entities.

In coming to this view, the Panel recognises that the requirements for board and executive remuneration would need to deal with structural issues in the superannuation sector, including that responsible executives may or may not be employees of the trustee and that remuneration may be paid from fund assets or from other sources. However, the Panel considers that the key management personnel requirements for disclosing entities in AASB 124 *Related Party Disclosures* (**AASB 124**) provide a basis for the development of these disclosures.

8.2.6 Related party information

In relation to the trustee, the website would have to contain at least:

- details of parties related to the trustee similar to that required for major listed entities; and
- the trustee's policy in relation to transacting with or investing in related parties.

Large APRA funds are already significant institutions in the Australian financial landscape. The Panel fully expects that the size and significance of large APRA funds — for the economy and community as a whole — will only increase in the future. The Panel observes that if superannuation fund trustees, as investors, expect this kind of information in relation to the listed entities in which they invest, fund members should also expect information of at least the same quality (and arguably higher) from the trustee itself, given that large APRA funds are not normal commercial enterprises.

The requirements for disclosing entities in AASB 124, and also the former key features statement regime,[47] provide a basis for the development of these related party disclosures.

8.2.7 Other information on fund websites

The Panel has also made a number of recommendations in other chapters that require trustees to disclose specific fund information on fund websites. These recommendations cover:

- governance information, including conflicts policy (chapter 2);
- voting information, specifically voting policies and procedures (chapter 3); and
- insurance information, covering terms and conditions and premium tables (chapter 5).

Recommendation 4.17

Trustees of large APRA funds should maintain a website that provides, free of charge, systemic transparency about the fund and the fund's management.

Recommendation 4.18

Trustees should retain the last 10 years' worth of such information and make it available on the fund's website.

8.3 Ratios

8.3.1 Management expense ratio (MER) and indirect cost ratio (ICR)

Traditionally, the funds management industry has used the 'management expense ratio' (**MER**) as a relative measure of the cost of managing funds. In 2005, the Corporations Regulations introduced the 'indirect cost ratio' (**ICR**) as part of a regime for fee and costs disclosure by super funds and managed investment schemes. The difficulty with both ratios is that they are not standardised or consistent in application.

MER is expressed as the management expenses such as investment management and administration divided by the funds under management. However, with MER, managers have the ability to treat certain fees as not being a 'management expense' and hence exclude them from measurement (simple examples include entry and exit fees). This is obviously unsatisfactory. MER is not a useful measure from a member perspective. It was traditionally used by trustees to assess the 'wholesale' cost of one investment manager as against another, assuming a lot of inherent knowledge about other relevant costs. Also, taxes and portfolio transaction expenses fall outside both the MER and ICR calculations.

Many submissions suggested that there was considerable ambiguity in application of these rules, and that the comparative value of the disclosure was reduced as a result.[48] ASFA also said that:

> *"Under the current rules investments could be arranged in such a way that the Indirect Cost Ratio (ICR) for many superannuation funds could be legitimately disclosed as zero. There is little scrutiny and, as such, grey areas in relation to the calculation of ICRs and MERs — need to encourage greater transparency in this regard. Clear standards in relation to the calculation of ICRs and MERs would help."*[49]

8.3.2 Total annual expense ratio

To resolve this, the Panel proposes that trustees publish on the fund website a new ratio for each MySuper product or choice investment option. The TAER would be an expense measure, assessing the ability of trustees in managing expenses within MySuper products or investment options of the fund derived from an outcomes reporting standard. The TAER would capture the total operating costs of the MySuper product or choice investment option to at least the first non-associated entity level. The total operating expense would form the numerator for a new expense comparability measure. The denominator would be the average net assets of the MySuper product or the investment option. Therefore, the TAER would be as follows:

$$= \frac{\textbf{Total operating expense}}{\textbf{Average net assets}}$$

The TAER would replace the MER and ICR. The methodology for calculating and disclosing the total operating expense would be developed as part of the outcomes reporting standard mechanism referred to earlier in sections 2 and 4.2 There would be no subjective assessment or other discretions as to whether or not a cost was a management expense. The outcomes reporting standard would overlay AAS 25 and would dictate that all operating expenses (of whatever nature) are to be included in the calculation. This would include portfolio transaction costs and other costs previously excluded from MER calculations.

The TAER would give members and other stakeholders a fairly reliable tool for making comparisons between MySuper products and investment options in the area of expense management, including via the 'dashboard' referred to in section 6.2.2.

Recommendation 4.19

Trustees should be required to publish on the fund website the historical Total Annual Expense Ratio (TAER), which would capture the historical costs to at least the first non-associated entity level, for each MySuper product or choice investment option within the fund.

The Panel has proposed in section 6.2.2 that trustees would need to disclose the projected TAER for all MySuper products and choice investment options in a product 'dashboard'. This recommendation would specifically require trustees to project the TAER, while the Panel's recommendation in this section requires trustees to disclose the historical TAER of the MySuper product or choice investment option. The Panel believes that this would benefit members and industry participants who could monitor trustee performance in the delivery of actual TAER against the projected TAER published on the 'dashboard'. This would also make trustees more accountable for the projections they make.

9 GOVERNMENT SUPER WEBSITE

9.1 A central source of information

The Panel believes that the basic features of super (for example, how it works; how it is taxed and a whole range of generic information) should be made available through a single widely publicised government website dealing exclusively with superannuation (www.super.gov.au). Almost all submissions to the Review that addressed this topic supported this idea. For example, Cbus submitted that it:

> *"Supports the development of a dedicated government website to educate members and contain generic material such as when members can access super, definitions of things such as preservation age and links to other helpful sites (eg FIDO on the ASIC website for comparison calculators). It underlines that the material is independent and does not promote products. As legislation changes quite frequently this would reduce fund costs in updating disclosure material and withdrawing communication material from circulation. More electronic communication will also assist in relation to the reduction of fund costs and therefore keep member fees as low as possible. However, those members with no access to this form of communication must still be catered for."*[50]

The website would be a one-stop-shop of all the information, products and tools currently provided by a wide range of government websites. This should provide Australians with the resources (such as general advice, statistics and educational material) to enable them to understand and navigate Australia's superannuation system, regardless of their own personal circumstances.

The creation of a government superannuation website could also provide a mechanism to allow comparison of MySuper products. While the Panel is recommending that this information be disclosed on fund websites (recommendation 4.3), the Panel sees no reason why the disclosure of the performance table (recommendation 4.10) for MySuper products could not be incorporated onto the government website. This was supported by IFSA who indicated that:

> *"Superannuation funds are currently assessed by a range of research and ratings providers (for example Super Ratings and Chant West Financial Services). Each has slightly different methods for assessing fund quality and features. We support the concept of industry-wide, standardised and comprehensive league tables to facilitate comparability."*[51]

Display of performance tables for choice investment options on the government website would be more difficult because it is not proposed that APRA collect the necessary data.

The information and resources provided on the government website should be complete; so that a full understanding of all the potential models (MySuper, SMSFs etc) is available. The extent to which this website may cut across what is provided by individual funds is something that would need to be considered in its design.

The Panel believes its objectives and that of the AFTS Review (recommendation 23 and in particular 23 (d)) are similar:

> *"(d) A superannuation portal where people can interact with government agencies and get information on retirement incomes should be developed. Over time this portal should evolve, subject to suitable safeguards, so that people can manage all their superannuation through one channel".*[52]

9.2 Better and cheaper disclosure

Submissions also generally agreed that a central government website would assist in making disclosure cheaper and easier for trustees by allowing them to link to such a site. This would significantly reduce the size of PDSs and would encourage each PDS to be more specific to the features of the fund itself. In other words, all funds disclosure documents could be linked to the government site and incorporate its contents by reference. That way, not only do members and potential members get access to all the generic information about super they need, but other disclosures do not need to repeat this material, but only refer to it.

This would save money, lead to simpler disclosure and ensure that the core information about super is presented uniformly and to a high standard. There is no point in requiring the private sector to interpret and regurgitate this information countless times across the system. This would also reduce fund compliance costs, as the material is being supplied by government.

Recommendation 4.20

Government should task ASIC, in consultation with industry, other regulators and consumer groups, to establish a central website about superannuation to draw together features, including standard disclosure of legislative, tax and other super-related features, and to be a portal to other superannuation-related information. All large APRA funds would be required to link their websites to this site.

APPENDIX 1

Squam Lake Working Group model[53]

Standardized Disclosure Label

Fund Name	Classic Market Index			
Fund Type	U.S Equity			
Fees and Expenses	**Annual**	**Buy**	**Sell**	**10-Year**
	0.30%	0.00%	0.00%	4.67%
Possible 10-year Payoffs (per $100)	**5%**	**50%**	**Average**	**95%**
	$49.54	$132.27	$158.07	$353.16
Turnover	4.00%			
Annual Volatility	20.00%			

Fees and Expenses and Possible Payoffs assume that, after making an initial investment, you reinvest all distributions and then sell the fund in 10 years.

Fees and Expenses

Annual	The percentage of your fund holdings that you pay for fees and expenses each year
Buy	The percentage of your investment that the manager takes when you buy this fund.
Sell	The percentage of your fund holdings that the manager takes when you sell this fund.
10-Year	The percentage of your investment that you will pay for fees and expenses (including buy and sell charges), on average, if you invest for ten years.

Possible 10-Year Payoffs

If you invest $100 for ten years, the final (inflation adjusted) value of your savings will be below the **5 per cent** payoff roughly 5 per cent of the time, below the **50 per cent** payoff roughly half the time and below the **95 per cent** payoff roughly 95 per cent of the time. Payoffs that are even more extreme than the 5 per cent and 95 per cent payoffs are possible. **Average** is the average of all possible payoffs.

Turnover	The percentage of the investment portfolio bought and sold each year.
Annual Volatility	A measure of risk. In a typical year, the return will fluctuate up or down by this much.

APPENDIX 2

Example costs within cost categories

Investment Management	Administration	*Legal and compliance*
▪ Investment manager fees ▪ Fees of underlying managers in fund-of-funds products ▪ Performance fees ▪ Investment costs represented by the difference between gross earnings by a manager and actual returns remitted to the fund ▪ Brokerage fees ▪ Custodian fees ▪ Asset consultant fee ▪ Implemented consultant fee ▪ Investment research costs ▪ Risk management	▪ (reporting, contribution management) ▪ External administrator fee ▪ Administrator performance fee ▪ Annual report/statement production ▪ Member engagement costs ▪ Call centre ▪ Website ▪ Postage and printing	▪ Legal fees ▪ Regulatory levies ▪ Accounting and audit ▪ Tax return/advice ▪ PDS preparation ▪ Unit pricing costs ▪ Actuarial costs
Taxation	***Member Insurance***	**Advice and distribution**
▪ Income tax ▪ CGT ▪ GST (including RITC) ▪ Withholding tax ▪ Stamp duty ▪ FBT	▪ Cost of premiums and managing/monitoring member claims	▪ Various payment models employed
Corporate overheads		
▪ Trustee/director fees ▪ Travel/accommodation ▪ Staff salaries ▪ Member benefit protection ▪ Rent and outgoings ▪ Advertising ▪ Sponsorship ▪ Events ▪ Catering ▪ Trustee indemnity insurance ▪ Equipment ▪ IT and telecommunications to support trustee operations, but excluding fund administration ▪ Subscriptions and conferences		

ENDNOTES

1 The Australian Financial Review, ‘Funds stay divided over reforms,’ 26 May 2010, p 53.
2 SIS Regulations 7.9.35 and 7.9.36, Corporations Regulations 2001.
3 APRA mission, <www.apra.gov.au/aboutapra/>
4 These include Chant West, Rainmaker and SuperRatings.
5 Chant West, Multi Manager Quarterly, V8, No. 1, March 2010
6 Gallery, Professor Natalie & Gerry, School of Accountancy, Queensland University of Technology: Accounting Impediments to Better Superannuation Fund Governance, Accounting, Accountability and Performance Vol 12, Number 2, 2006, p 33.
7 Item 205 of Schedule 10, Corporations Regulations 2001.
8 Compound 5 and 10 year investment return reporting requirements after 30 June 2010 - Regulations 7.9.20(1)(n) and 7.9.20AA(8), Corporations Regulations 2001.
9 An incentive to do so for the annual report to be one of the vehicles to provide members with the information on investment options necessary to support a member's investment direction as generally required by regulation 4.02 of the Superannuation Industry (Supervision) Regulations 1994.
10 IFSA is reversing this Standard as part of its Super Charter.
11 'Review of Current Australian Requirements and Options for Reform - Report to the Australian Securities and Investments Commission', published as ASIC Report 16, September 2002.
12 ASFA, Submission no. 147, p 38 (appendix 1).
13 Derived from APRA's Superannuation Fund Level Profiles and Performance Characteristics, as at 30 June 2009.
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17 DALBAR Inc, Quantitative Analysis of Investor Behavior, 2005
18 ASFA, Submission no.436, p 7.
19 ASFA, Submission no. 32, p 24.
20 Morningstar, Submission no. 171, p 5.
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25 AIR, Submission no. 24, p 16.
26 Regulation 4.02 SIS Regulations
27 Minister for Financial Services, Superannuation & Corporate Law & Minister for Human Services Media Release No. 71, 23 June 2010, and Corporations Amendment Regulations 2010 (No. 5), SLI 2010 No. 135.
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29 Squam Lake Working Group: Martin N. Baily (Brookings Institution), Frederic S. Mishkin (Columbia University), Andrew B. Bernard (Dartmouth College), Raghuram G. Rajan (University of Chicago), John Y. Campbell (Harvard University), David S. Scharfstein (Harvard University), John H. Cochrane (University of Chicago), Robert J. Shiller (Yale University), Douglas W. Diamond (University of Chicago), Hyun Song Shin (Princeton University), Darrell Duffie (Stanford University), Matthew J. Slaughter (Dartmouth College), Kenneth R. French (Dartmouth College), René M. Stulz (Ohio State University), and Anil K. Kashyap (University of Chicago).

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31 Rice Warner Actuaries, Submission no. 233, p 24.
32 For example, VicSuper.
33 Squam Lake Working Group, 'Regulation of Retirement Saving', July 2009.
34 In Australia, see Coleman, A. D. F., N. Esho and M.Wong. (2006). 'The Impact of Agency Costs on the Investment Performance of Australian Pension Funds'. Journal of Pension Economics and Finance, 5(3), 299-324; Sy, W. and Liu, K. (2009), 'Investment performance ranking of superannuation firms', APRA Research Working Paper <www.apra.gov.au/Research/Working-papers.cfm>; More broadly, see Javier Gil-Bazo and Pablo Ruiz-Verdu, 2009, 'The Relation between Price and Performance in the Mutual Fund Industry' Journal of Finance 64, pp. 2153-2183; J Chevalier and G Ellison, 1999, 'Are some mutual fund managers better than others? Cross-sectional patterns in behaviour and performance' Journal of Finance 54, 875-899; Bogle, J.C. (2008),'A question so important that it should be hard to think about anything else', The Journal of Portfolio Management, Winter 2008, pp.905-102.
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42 Section 30(b) of the Investment Company Act of 1940 and Sections 13(a) and 15(d) of the Securities Exchange Act of 1934.
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44 Section 1017C(5) Corporations Act 2001 and Regulation 7.9.45 Corporations Regulations 2001.
45 Treasury estimate that the superannuation industry receives $22B a year in tax concessions.
46 ICAA, Submission no. 137, p 15.
47 See paras 63 to 69 of the Key Features Statement regime contained in the determination made under s 153 of the SIS Act on 14 October 1997 by the Insurance and Superannuation Commission.
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49 ASFA, Submission no. 147, p 37 (appendix 1)
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