Institute of Actuaries of Australia

MySuper
The Treasury
CANBERRA

31 May 2011

Stronger Super Proposals – MySuper and Important Related Issues

The Institute of Actuaries of Australia ("the Institute") is the sole professional body for actuaries in Australia. It represents the interests of over 1,500 Fellows and 2,000 other members.

The Institute has been involved in the recent MySuper Working Group and some of the views in this letter have been expressed there.

For the record, we are now putting a number of issues in writing for Treasury to consider as they move on to the detailed implementation of the MySuper reforms. We make recommendations on seven aspects of how the proposed reforms would be implemented if they were to closely follow the Government's response to the Super System Review.

Whilst some of the recommendations relate to the six Issues Papers considered by the MySuper working group, others relate to an important issue that we believe should be considered at the same time – that is the calculation and presentation of investment earning rates. This is a key underlying issue for MySuper and other parts of the proposed reforms. This is an area in which our members have considerable technical expertise and practical experience, and we considered it vital that superannuation funds calculate and present their returns in a consistent and technically correct manner.

Issues 1, 3, 4 and 6 use the terminology "fees and costs". Consistent with the Corporations Regulations, the words "fees and costs" are intended to include expenses which impact on members' benefits but which are not included in fees.

ISSUE 1: Subdivision of Fees and Costs into Investment and Other Components.

RECOMMENDATION 1: Superannuation funds should be required to disclose investment costs separately from other costs for all reporting purposes.

The Institute considers it is essential for superannuation funds to subdivide fees and costs into an "investment" and an "other" component (which would include administration fees and costs). This is essential to allow –

(a) **Calculation on a meaningful basis of the net investment return** achieved by a fund, or by an investment option within a fund; and

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(b) **Disclosing a fund's fees and costs in its Product Disclosure Statement** on a basis which enables comparison of funds on a sound basis.

We understand one of the prime objectives of the Stronger Super proposals is to enable members to easily compare different superannuation funds and the services that they provide. To achieve this objective it is vital that members are aware of the services provided by each fund and the costs associated with providing these services. With respect to investment and administration services it is therefore imperative that the costs of each of these services be identified separately.

Note that (a) does not require a subdivision be shown in each member's account statement. All that is required is that only the total investment costs for the calculation period for the fund (or investment option), or an allowance for these costs, be deducted in the calculation of the net investment return for the fund (or investment option) that is reported to members.

In regard to (b) the Institute supports the simple and succinct method of describing these fees and costs set out in the "Way Forward" submission dated 4 November 2009 to the Super System Review by two of our members, Colin Grenfell and Ray Stevens.

Our submission of 18 November 2009 to Phase two of the Super System Review is attached as Appendix 1. It provides more detail on this issue.

ISSUE 2: Differences between "earning rates" and "crediting rates".

RECOMMENDATION 2: APRA or ASIC should provide guidance to the industry that acknowledges the difference between earning rates (net investment returns) and crediting rates (the amounts allocated to member accounts).

All defined contribution funds allocate investment income to member accounts on a regular basis either via unit prices or via crediting rates. In some cases, the amount of investment income allocated to members will equal the actual net investment income earned by the assets supporting those members' accounts. In other cases, the amount allocated will be less than the net earnings because, for example, they deduct a further asset-based fee to cover part of administration costs or they deduct amounts to build up operational reserves. The "allocation rate" used to distribute investment income to members' accounts may or may not be equal to the actual net earning rate achieved on the assets supporting the members' accounts.

When comparing the investment performance of funds or investment options this should be based on the net earning rates achieved by the assets supporting the members' accounts, regardless of the distribution method. Where crediting rates are different from earning rates, it can be appropriate to use such crediting rates for some purposes e.g. on a member benefit statement. Whenever a rate is disclosed or reported one must determine which the correct rate is, and ensure the two types of rate are not mixed up in the same table.

We are concerned that research houses and many funds are not reporting and comparing "like-with-like". Investment performance tables may actually be a mixture of earning rates and crediting rates, which is misleading.

If Stronger Super results in APRA publishing "lLeague tables" of earning rates which are intended to be used by a person selecting a fund, it will be even more important to ensure the correct rate is used for this purpose.

The Institute has over the past few years drawn this issue to the attention of APRA, ASIC and the Super System Review, however the issue remains unresolved.

Though no changes seem to be required to the Corporations Act 2001 or Corporations Regulations, we recommend that this issue be addressed and guidance given to the industry before implementation of a number of the related Stronger Super proposals.

A letter to APRA on this issue from some of our members on 12 August 2010 is attached as Appendix 2.

ISSUE 3: Calculation of Net Investment returns

RECOMMENDATION 3: The Government should direct APRA and ASIC to develop a standard for reporting investment returns which ensures that net investment returns include an allowance for investment costs only, not for administration or other services.

Recommendation 4.8 of the Super System Review recommended that APRA be asked to develop a standard for reporting investment returns including the return "net of all costs (administration and investment)".

The Institute strongly recommends that "net investment returns" should not be calculated by deducting administration costs as well as investment costs. Net investment performance and presentation should allow only for investment fees and costs and investment taxes. Other fees and costs and taxes bear no relation to the management of the investment portfolio. A fund or investment option should not be considered to have inferior investment performance because it provides a wider range of services which incur higher administration fees.

Since 1996, the Institute's Professional Standard 101 on "Investment Performance Measurement and Presentation" has required actuaries to determine net investment returns based on the deduction of only investment fees and costs. In July 2010 the standard for member funds of the Financial Services Council was also changed to this basis, but subsequently the change was deferred because of pending FOFA legislation. In 2009 the United States introduced legislation for its 401k plans which is in line with the above methodology. The practice in a number of other countries is also on this basis.

In its response to the Super System Review recommendations the Government has asked APRA and ASIC to develop standards for calculation and presentation of investment returns. We recommend that these standards are not implemented on the basis of the Super System Review recommendation 4.8 in respect of the deduction of non-investment

fees and costs and contributions tax, but should deduct investment-related fees, costs and taxes only.

ISSUE 4: Proposed use of Total Annual Expense Ratio (TAER)

RECOMMENDATION 4: The Government should not proceed with the use of a TAER.

We are concerned about the proposed use of a "Total Annual Expense Ratio" (TAER) referred to in Recommendations 4.12 and 4.19 of the Super System Review.

We understand that for a fund as a whole the TAER for a fund year is calculated by dividing –

(a) the total expenses in that year incurred by the fund itself and also paid by the fund to non-associated entities, usually investment managers; by

(b) the average value of the fund's assets in that year.

We also understand a TAER would have to be calculated on the same principles for each investment option.

Recommendation 4.12 would require publication of the "projected" TAER, which we presume is an estimate of the TAER for the current fund year. Recommendation 4.19 would require publication of the TAER's for an unspecified number of previous years.

The TAER is basically the plan (or option) average expense rate. This is meaningless for an individual member, and will often bear little resemblance to the fees and costs actually paid by an individual member as these will sometimes depend on the level of the member's contributions and often depend on the balance in their account. As the TAER is based on a mixture of investment and administration expenses it also has similar deficiencies to those referred to in Issue 1. If two funds have identical fee and cost bases for individual members they will probably have different TAER's because of different relative asset values. This shows that TAERs will normally provide misleading information for members and lead to incorrect decisions being made by members.

Apart from the question as to whether a TAER could serve any useful purpose, it would be extremely difficult to ensure all funds calculated the ratio on a consistent basis. For example, administration expenses for the year would presumably be allocated to investment options pro rata to the average value of the assets for that option. If in a particular year there was a substantial fall in the value of the assets for say the equity share based option, which was not matched by the other options, this would increase the administration expenses allocated to non-share options. So the TAER for the options not affected by the share crash could be significantly increased. There would be many other anomalies.

We do not support the use of TAERs on the basis that it is a flawed measure that does not present any clear benefits for members.

ISSUE 5: APRA's suggested investment risk description based on negative returns.

RECOMMENDATION 5: Treasury should initiate further consultation for the purpose of developing an annual return based measure allowing for inflation risk, and the eventual proposals should be carefully consumer-tested.

In June 2010, APRA advised trustees of regulated superannuation funds that, in consultation with IFSA, ASFA and ASIC, it was developing some guidance for more uniform and objective labelling of the investment options offered by superannuation funds. The guidance included showing the expected frequency of negative (assumed to be annual) returns over a 20 year period for each investment option.

Recommendation 4.9 of the Super System Review was to show the number of quarters of negative returns the option had incurred in the past 10 years.

The Institute is concerned that "Quarters of negative returns" is a poor discriminator of investment risk.

The Institute's Benefit Projections Working Group has examined each of the above and has concluded that the number of negatives in 20 annual periods is a better differentiator of volatility than the number of negatives in 40 quarterly periods. For example, based on one set of historical 40 quarterly returns, the number of negatives were:

Period Ending	"Balanced"	"Capital Stable"
30/9/2008	12	11
31/12/2008	13	12
31/3/2009	14	13
30/6/2009	13	12

The number of negative quarters in 40 quarter periods is clearly not a satisfactory differentiator. We also feel that consumers will relate better to annual periods than to quarterly periods. Hence we favour the APRA approach over Recommendation 4.9 of the Super Review. However we have the following reservations about the APRA approach:

(a) It should be clearly stated that the investment returns used should be based on "earning rates" (net of tax in the accumulation stage and gross of tax in the decumulation stage) not "crediting rates" where the purpose is or might be to compare like options between funds (See Issue 2 above.)

(b) It might be satisfactory to use "crediting rates" where the purpose is (only) to compare investments options within one fund.

(c) More research is possibly desirable before deciding whether the appropriate period is 20 years, 25 years or 30 years.

(d) Is a more relevant statistic showing whether the option has produced a net return exceeding inflation (according to CPI or AWOTE) over say the past 5 years or 10 years or is there some other way of better illustrating the relative or absolute risk of various options?

We suggest some members of the Working Group could be involved in future consultations on this issue and that the eventual proposals should be carefully consumer-tested.

The letter to APRA on 12 August 2010, is relevant to this issue.

ISSUE 6: Cost Categories

RECOMMENDATION 6: Cost category reporting should be simplified to allow for Investment, Administration and Advice categories only and for all purposes.

Table 4.2 of the Super System Review proposed that superannuation costs reported to APRA should be separated into the following seven categories:

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

This is a very ambitious proposal and in our view it is fraught with danger, is overly complex and will be costly to implement and maintain. In contrast, our submission of 18 November 2009 on the Review into the Operation and Efficiency of Australia's Superannuation System attached as Appendix 1 to this submission, is far more modest, and recommended that fees, cost and expenses all be separated into:

- Administration
- Investment
- Advice fees

Our submission stresses the importance of one split for all purposes. To clarify our third recommended category above, 'Advice fees', this would treat advice fees paid by a fund as fund administration expenses but would treat advice fees paid by members as fees to be disclosed to members separate from "administration" fees and costs and separate from "investment" fees and costs.

It should be noted that this issue is not just a matter of seven versus three categories. For example, our "administration" and "investment" components would each include (unless zero or insignificant) a portion of "Corporate overhead", "Legal and compliance" and "Taxation". Also our "administration" includes "advice and distribution", "Member

insurance" and (unless zero or insignificant) a portion of "Corporate overhead", "Legal and compliance" and "Taxation".

Our submission of 18 November 2009 to Phase two of the Super System Review, attached as Appendix 1, is relevant to this issue.

ISSUE 7: Retirement Income Forecasts

RECOMMENDATION 7: The Government should require Retirement Income Forecasts to be mandatory for at least MySuper products.

Recommendation 1.17 of the Super System Review was that retirement forecasts should be mandatory for MySuper products. The Government did not support this recommendation, but did ask ASIC to continue development of rules for voluntary issue of retirement income forecasts by superannuation funds.

The Institute has done considerable work on the regulation requirements for mandatory and voluntary benefit projections with ASIC and the Australian Government Actuary. In April 2008 our Benefit Projections Working Group issued a 45 page Discussion Paper on "Outstanding Issues for Benefit Projections and Online Calculators". This paper identified a number of "gaps" in the rules and practice in this area, with suggestions to address these issues.

In July 2008, ASIC issued Consultation Paper 101 which set out for comment its proposals for action in the field.

The Institute considers that the issue to superannuation fund members of a printed estimate of the income the member is likely to receive in retirement from the superannuation and Age pension systems would be extremely useful to members (and the community). It would encourage members to take more interest in their superannuation and indicate whether the member should be considering making additional voluntary contributions to achieve an adequate retirement income. In 2008 there was wide discussion in the industry and the wider community of the desirability of making it mandatory for superannuation funds to issue benefit projections either annually or say every 3 years.

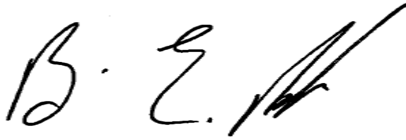
The Institute was disappointed to note the Government did not support the Super System Review recommendation to introduce mandatory projections for at least MySuper products. With mandatory projections the Government can have stronger control over the uniformity and quality of the information provided. It is also likely to be more economical and effective than a system of voluntary statements by some funds in a variety of formats.

We recommend the Government support mandatory retirement income forecasts for at least MySuper products.

Our 30 July 2010 joint submission with the Association of Superannuation Funds of Australia (ASFA) to ASIC is attached as Appendix 3.

If required, we would be happy to discuss our views on this matter. Please do not hesitate to contact Melinda Howes, CEO on (02) 9239 6106 (melinda.howes@actuaries.asn.au).

Yours faithfully



Barry Rafe
President

Encl: Appendix 1: Letter to Super System Review dated 18 November 2009 (with enclosures of letters dated 17 July 2008, 1 July 2009 and 4 November 2009)
Appendix 2: Letter to ASIC from BPWG dated 12 August 2010
Appendix 3: Joint submission from Institute and ASFA to ASIC dated 30 July 2010

Cc Mr Greg Medcraft
Chairman of the Australian Securities and Investments Commission (ASIC)

18 November 2009

Super System Review
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Dear Sir/madam,

Review into the Operation and Efficiency of Australia's Superannuation System

The Institute of Actuaries of Australia (the Institute) is the sole professional body for actuaries in Australia. It represents the interests of over 1,500 Fellows and 2,000 other Members.

The Institute welcomes this opportunity to make submissions in relation to phase two of the Super System Review. In this submission we would like to make four specific recommendations which we consider would significantly improve the operation and efficiency of Australia's superannuation system. In a second submission, which we hope to forward in early December, we plan to provide more detailed comments on some of the questions posed in your 16 October 2009 Issues Paper.

Our four recommendations are:

First Recommendation

All superannuation fund expenses and superannuation fees and costs which impact on members' benefits should be subdivided into an "investment" component and an "administration" component for all purposes. All purposes would include plan and member reporting, PDS disclosure and APRA fund expense statistical reporting and the definition of the "investment" component would be consistent with Corporations Regulations 7.9.01 which refers to "… relating to the management of investment of fund assets".

Second Recommendation

The "administration" component of fees and costs (which forms part of our first recommendation) should be referred to as "superannuation fees and costs" and this new terminology should be mandatory and clearly specified in regulatory guidance and/or legislation and with effect from a date consistent with other Super Review proposals.

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Third Recommendation

"Superannuation fees and costs" (as defined above) may include advice costs which are not covered by specific advice fees, but any advice costs which are covered by specific advice fees must be disclosed separately as a third component of fees and costs. In any case, all advice costs must either be included in superannuation fees and costs or identified separately.

Fourth Recommendation

Two members of the Institute (Colin Grenfell and Ray Stevens) have made recommendations to the Super System Review suggesting a three level superannuation fee and cost disclosure framework. Their proposal is entitled the "Way Forward". The Institute wishes to support this proposal and recommends that it should be subject to rigorous consumer testing to confirm its suitability and to identify further improvements.

In each of these four recommendations we have used the terminology "fees and costs". Consistent with the Corporations Regulations, the words "and costs" are intended to include expenses which impact on members' benefits but which are not included in fees.

These four recommendations represent a consolidation of the following submissions that the Institute (and two of its members) have made to various government agencies during the past 16 months:

(a) Institute Submission of 17 July 2008 on "Intra-Fund Advice" to the Financial Services Working Group,

(b) Institute Submission of 1 July 2009 on "Enhanced APRA superannuation statistics collection" to the Australian Prudential Regulation Authority, and

(c) "Way Forward" and submission of 4 November 2009 by Colin Grenfell and Ray Stevens on "Disclosure of Superannuation Fees and Costs" to phase two of the Super System Review.

To give further background, copies of these submissions are enclosed with this submission. There are also two appendices to this submission. Appendix A explains the reasons supporting the first recommendation. Appendix B explains some safeguards that should be considered to ensure that plan sponsors do not manipulate expense, fee and cost subdivisions to try and gain perceived competitive advantages.

If required, we would be happy to further explain or discuss these four recommendations with you. Please do not hesitate to contact Andrew Boal, Convenor of the Institute's Superannuation and Employee Benefits Practice Committee on (03) 9655 5103 (Andrew.Boal@watsonwyatt.com) in this regard, or for any further information.

Yours faithfully

Trevor Thompson
President

Institute of Actuaries of Australia

APPENDIX A

REASONS FOR SEPARATING FEES AND COSTS INTO INVESTMENT AND NON-INVESTMENT COMPONENTS

[*Five fruit or two apples and three oranges ?*]

The Institute's first recommendation is:

All superannuation fund expenses and superannuation fees and costs which impact on members' benefits should be subdivided into an "investment" component and an "administration" component for all purposes.

Without this it is not possible to give members and prospective members a sound basis for comparing the costs of two or more superannuation funds. To do this effectively, members need to know and consider:

(1) The fund administration fees and costs (and the services provided for those fees and costs), and

(2) The investment fees and costs (and the expected net investment returns) in respect of all the various investment options.

Administration fees and costs and investment fees and costs have different attributes which make it necessary to demonstrate their effect on members in different ways. This can only be done if the fees and costs are subdivided into administration and investment components. The most relevant attributes making subdivision essential are as follows:

ATTRIBUTES OF ADMINISTRATION FEES AND COSTS

1. Administration costs incurred by a fund are usually higher in the year the member is enrolled in the fund (marketing cost may also be significant) and in the year the member receives or commences to receive a benefit. In the intervening years servicing costs are lower and are often not expected to vary much from year to year. Funds seeking to allocate costs between members on an equitable basis reflect this pattern in the way fees and costs are deducted from member accounts. The costs to be met by a member should therefore be measured over the period of membership. As that period is not known in advance, figures for comparison between funds need to be provided for a number of membership periods - five periods are used in the recommended basis submitted.

2. Administration costs often vary according to the level of contribution (and/or the size of account balances) so that costs for more than one contribution level need to be provided for comparison of funds - two contribution levels are used, in the recommended basis submitted.

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3. In addition to the above variations in administration costs, the general level of a fund's administration fees and costs can vary from year to year e.g. in the year a major upgrade of the fund's computer administration system is necessary. For a fund operated by an institution the costs charged to members from year to year may be relatively stable as the institution may absorb the fluctuations over a period and make less frequent revisions to the fees payable to the institution by the fund. For a mutual fund, such as the typical industry or corporate fund, the fee may he relatively stable where administration is outsourced. The service provider may absorb the fluctuations over a period. However for a mutual fund handling all or most administration in-house, the costs can vary significantly from year to year. As the fees deducted from members' accounts in any year will differ from the actual costs in that year the difference is typically deducted from or added to investment income for that year. This is disclosed as a positive or negative "percentage of assets" administration fee or cost and may be averaged over say two or three years. (Other funds address this problem by putting administration fees deducted from member accounts into an account and paying administration expenses from that account. If the amount in the account is not sufficient, administration fees have to be increased. The current balance in the account may be disclosed in the PDS.)

ATTRIBUTES OF INVESTMENT FEES AND COSTS

1. Investment costs vary significantly (and reasonably) for different types of investment, typically being higher for growth investments such as shares and property. Accordingly costs must be disclosed separately for each investment option offered by the fund. For a master trust or similar offering a choice of investment manager as well as a choice of investment types, the number of options can be very large.

2. Investment costs for a particular investment type or option are not expected to vary much from year to year as a percentage of assets (except for performance fees). Accordingly it is usually sufficient to provide fees and costs for a single year for a valid comparison of funds.

Some have suggested it would be easier for members if the level of investment and administration fees and costs could be illustrated using one combined figure for the fund. This would be done by using only the investment cost for one investment option being that for a "balanced investment option". First this would not overcome the need for separate administration costs for different membership periods and different contribution levels. Secondly there is no such thing as a standard "balanced investment option". Some might include the same proportion of share investments but use different proportions of Australian and International shares. Some include infrastructure assets while others do not. Some might include a higher level of passive investments in the example used in the PDS and reduce or even exclude any active investments from the example. Some funds do not even have an investment option which could be regarded as a balanced investment option. Two funds could have the same basic fees and costs for their administration but the figures in the PDS could be very different because of the asset-mix used to calculate the cost for the "balanced option". While it would be simple to have just one figure it could be misleading and therefore may lead to the selection of a fund that does not best meet a person's requirements.

Cost is not the only factor to be taken into account in selecting a fund. Different people want a different range of administration services. A person in stable employment and not close to retirement may only need basic administration services. A person who changes jobs frequently or is self employed or retired may have very different requirements. Likewise some want access to a wider range of product features (such as contribution, insurance, disablement and pension alternatives) and investment choices. Having separate figures for administration and investment costs is not only more accurate for comparison purposes but makes it easier to select a fund providing the administration services required and the desired range of investment options.

The basis for disclosure submitted makes it easier for members and prospective members, not by compromising on the validity of the fund comparison but by using two simple tables, one for administration and one for investment. Also, where the administration element has more than one fee and cost component, the third step of the suggested disclosure regime avoids the need for the person to understand how each administration fee or cost component is calculated. It is the aggregate effect of these components as shown in the table which the person needs to know.

A beneficial consequence of the separation of fees and costs into "investment" and "administration" is that the unnecessary and confusing terms "management costs" and "other management costs", which are currently specified in Corporations Regulations, can be dispensed with.

Splitting the fees and costs is consistent with the definition of "net earnings" in Corporations Regulation 7.9.01. Also, in the United States new legislation was recently passed which requires 401k plans to separate their fees into administration and investment management components. Our recommendations are consistent with overseas developments.

We believe that separation of administration fees and costs from investment fees and costs is not difficult. Trustees will usually know the investment component of fees and costs, or can make a reasonable estimate. In practice, we believe that many trustees will already be regularly making a subdivision of these costs as part of normal internal supervision of the costs of operating the fund. Guidelines could be issued to clarify some details and achieve consistency.

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APPENDIX B

SAFEGUARDS AGAINST MANIPULATION OF FEE/COST SUBDIVISION

It has been suggested that some fund sponsors might seek to manipulate the split of fees and costs into administration and investment components to achieve a perceived competitive advantage.

For example an unsolicited benefit projection (or "superannuation forecast") provided by a fund may be required to be based on a standardised net investment return, which accordingly allows for investment costs on a standardised basis rather than the actual investment fees and costs of the fund, but using the particular fund's actual administration fees and costs. There is an incentive for a fund to allocate more of its fees and costs to the investment component so that the administration costs component used in the projection is reduced while the investment costs used are not affected.

Another situation relates to the basis for fee and cost disclosure in a Product Disclosure Statement (PDS) referred to at the beginning of this submission. The recommended approach uses a projection to illustrate the effect of the fund's administration fees and costs. To ensure these projections provide a valid basis for comparing the fund's administration fees and costs with other funds, the projections use a standardised net investment return in conjunction with the fund's actual administration fees and costs. This means the only difference between the projection results from fund to fund must be due to the differences between the administration fees and costs for the funds being compared.

If considered necessary the regulator could require the fund auditor as part of the annual audit to certify that the subdivision of fees and costs into administration and investment components has been done on a reasonable basis and in accordance with any guidelines issued by the relevant regulator. Any split would have to be applied consistently from year to year. Where a split involves some degree of estimation it is to be expected that there will be differences between splits done by different people. These differences should not be large enough to be of concern and we note that the total costs disclosed should still be accurate.

However there are a number of reasons why a fund could find it difficult to distort the subdivision or risk being caught out doing so:

1. If trustees moved some of their administration costs into their investment costs the annual dollar investment costs required to be shown in the PDS under the recommended proposal would be inflated. Also the reported past investment returns would be deflated (see Corporations Regulation 7.9.01).
2. In many cases the investment and administration managers are separate unrelated entities. An investment manager for whom inflated costs are shown is likely to pick up the distortion. Where the fund has an investment consultant the chance of detection is even higher.

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3. Most funds offer more than one investment choice. Any distortion would need to be made consistently across all investment options, making detection at some stage more likely.
4. When there is a change of investment manager or administrator or an additional investment manager is appointed the chance of detection is high.
5. Financial Planners and competitor funds may detect the practice.
6. If a fund is detected as using this practice the publicity is likely to permanently damage that fund's reputation and the reputation of any adviser found to have been involved in the deception.
7. Any such deception is likely to contravene Corporations Regulation 7.9.10E (1) and (2) regarding misleading information and/or SIS Act sections 52(2) and 52(4) regarding trustees' fiduciary duty to act in the best financial interests of members.

Institute of Actuaries of Australia

17 July 2008

Financial Services Working Group
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Dear Sir/Madam

Submission on the Consultation Paper
Simple Advice on Choices Within an Existing Superannuation Account (Fund)

The Institute of Actuaries of Australia ("the Institute") is the sole professional body for actuaries in Australia. This submission is provided in response to the Consultation Paper (the Paper) on *Simple Advice on Choices Within an Existing Superannuation Account*, that is on "Intra-Fund Advice".

In addressing the issues in the Paper, it is the view of the Institute that:

- Improved access by superannuation fund members to basic, cost effective advice is highly desirable.
- Such basic advice would address many of the fundamental question members need help with, particularly in the early years of their superannuation savings plan.
- The provision of simple benefit projections and illustrations to members by funds would provide significant assistance in this respect.

Nonetheless, improved superannuation decision making by members can only come from education, provision of information or advice. The provision of these all come at a cost and carry liability. In this case we note:

- For many members and particularly those least familiar with financial matters, information and advice are less costly than education (albeit that education is important and can follow for many with increasing familiarity and as account balances increase).
- The liability aspects of provision of advice is particularly unclear.

Ultimately the choice for government is a risk/return trade off between more accessible information/advice for members and the risk of instances of poor or misunderstood advice.

We set out in the attached our observations and comments on a number of common situations and issues that funds and their members confront. In each case we suggest how some practical and useful, basic advice could be provided to members that balances the above issues.

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We hope that the Financial Services Working Group finds the attached to be of assistance. We would be pleased to provide further input on these matters, should you consider that desirable or helpful. Please do not hesitate to contact the Institute's Chief Executive Officer, Mr John Maroney (02 9233 3466; john.maroney@actuaries.asn.au).

Yours faithfully

Greg Martin
President

Institute of Actuaries of Australia

Intra Fund Advice

Issue 1: Paper Based (or Provider Generated) Benefit Projections

The Issue

Few funds are providing paper based benefit projection statements (forecasting benefits at retirement)

Paper-based superannuation benefit illustrations are forecasts of a member's likely superannuation benefit in the future (usually at typical retirement ages) based on assumptions about future investment returns and future contributions.

They are an extremely useful and cost effective form of intra-fund advice which helps members to plan for their retirement. In our view, the provision of such benefit projections would provide highly valuable basic information to members considering their current superannuation arrangements and contribution levels.

The Institute is aware that many superannuation fund trustees are keen to provide members with annual statements of their projected benefits. Trustees often look to actuaries to make, or assist in making, these calculations and the Institute has issued a Guidance Note to its members on the technical aspects of such calculations.

Trustees have generally not issued such illustrations in recent years because they are not sure whether this is permitted under the advice provisions of the Corporations Act.

While trustees are able to offer benefit projection web calculators to members (due to a clear exemption from the advice provisions of the Corporations Act - Class Order 05/1122), only a small proportion of fund members actually access these calculators. This is mainly because members have to seek out the information themselves (rather than it being automatically provided to them).

Paper based projections would have a much greater reach and would encourage more members to use web calculators.

While we have used the expression "paper-based" benefit projection in this submission, these comments apply equally to electronic copies of these projections that might be emailed to members (or indeed made available on a website).

Electronic copies of benefit projection statements are different to a web benefit projection calculator in that:

- They have been instigated by the Provider not by the member.
- The data and assumptions have been set by the Provider.

We have therefore used the term "Provider Generated" benefit projection statement to cover both paper based statements and electronically provided statements.

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We note that the Australian Government has announced its intention to make benefit projection statements compulsory for superannuation funds - "Universal Retirement Income Forecasts" (URIFs) in the near future.

While the Institute welcomes the URIFs, the Institute believes the regulatory barriers to providing benefit projections should be addressed before the introduction of the URIF because:

- These legislative barriers will need to be considered in any case when drafting the URIF legislation.
- Trustees may wish to introduce such projection statements in advance of the URIF.
- Trustees may wish to issue additional projections to the URIF (perhaps containing different information or having a different format).

Barriers

1. Uncertainty about whether paper based benefit projections are considered "personal advice"

We are aware of a variety of different legal opinions (and trustee practice) as to whether paper based Benefit Projections represent personal advice. Our discussions would suggest that the predominant view is that the paper benefit projections are considered to be providing personal advice.

In ASIC's Regulation Impact Statement to Class Order 05/1122 (providing relief for generic calculators), ASIC states that: *"the financial product advice provided by many calculators is likely to be personal advice"*

because:

" calculators typically require the user to input information about their financial objectives, financial situation or needs (e.g. information about their initial investment, investment timeframe, ongoing investments, salary, age etc). The generic calculator then uses this information to generate a result. In doing so, the generic calculator has taken into account at least one aspect of the user's objectives, financial situation or needs."

Provider Generated benefit projections require the Provider to input information about a member's financial objectives, financial situation or needs (e.g. information about their initial investment, investment timeframe, ongoing investments, salary, age etc).

Similar arguments about calculators can therefore be applied to paper based benefit illustrations to suggest that they are in fact providing "personal advice"

Different levels of advice

The level of advice provided by a paper based benefit projections (or indeed web calculators) may vary depending on the inputs used and the output produced. In particular, the strength of advice depends on the degree to which the benefit projection encourages action (eg. to make additional contributions or even to do nothing).

Examples of the different levels of advice in benefit projections are:

Level of Advice / Strength of Recommendation	**Nature of Benefit Projection**
Low (factual)	Pure forecast – a projection of likely future benefits based on current contribution rate.
Medium	Pure forecast, plus a further illustration showing the impact of making extra contributions (eg. what difference does an extra 5% contribution make).
High	Pure forecast plus an additional projection to work out the level of additional contributions required to achieve a particular target retirement income. The target may be nominated by the individual or recommended by the licensee (that latter being an even higher level of advice).

2. Uncertainty as to whether Class Order 05/1122 applies

If paper based projections are considered to be providing “personal advice”, then the advice provisions of the Corporations Act may apply, requiring the licensees to issue a statement of advice and to have a reasonable basis for that advice.

Online calculators may also provide personal advice, but are exempt from the advice provisions of the Corporations Act if they meet the requirements of the Class Order Exemption CO 05/1122.

The Class Order applies to "financial calculators", defined as:

“financial calculator means a facility, device, table or other thing used to make a numerical calculation or find out the result of a numerical calculation relating to a financial product”

Note: The facility, device, table or other object will not be a financial calculator to the extent that its output goes beyond the numerical result of a calculation and a description of what that result is. For example, an electronic facility will not be a calculator to the extent that it makes a recommendation about a particular kind of financial product.

We note that the class order exemption is broader than just online calculators. It covers all "financial calculators" including those generic paper based "ready reckoners" which allow members to work out future benefits for themselves.

However, there are a variety of legal opinions (and trustee practice) as to whether the class order exemption applies to paper based benefit projections and whether these fall within the definition of financial calculator.

3. Know your client rule

If paper based benefit projections are considered to provide "personal advice" and the class order does not apply, a statement of advice is required. The Corporations Act imposes an obligation on the licensee to have a reasonable basis for the advice.

Section 945A(1)(a) of the Corporations Act states that:

(1) The providing entity must only provide the advice to the client if:
the providing entity:
(i) determines the relevant personal circumstances in relation to giving the advice; and
(ii) makes reasonable inquiries in relation to those personal circumstances.

Regulatory Guide 175 [RG175.102] to [RG175.108] further expands on the obligations in 945A(1)(a) In particular:

- *The obligation to determine a client's relevant personal circumstances .....cannot be avoided [RG175.102].*
- *The obligation is "scaleable"……… [RG175.103]*
- *Where a client is not interactive….the providing entities need to consider whether they are able to adequately conduct client inquiries using remote communication methods. [RG175.106]*
- *Where advice is provided to existing client…945A(1)(a)(ii) will generally be satisfied if the providing entity makes reasonable inquiries about whether the information already held about the client's relevant personal circumstances is up-to-date and complete. [RG175.107]*

We are aware of a variety of legal opinions as to how the obligation to have a reasonable basis for advice would apply in relation to paper based benefit projections.

Trustees of large funds may have concerns that under these requirements, they cannot have a reasonable basis for advice as it would be impractical to contact each member to obtain the minimum required information.

Proposed Solutions
(in order of preference)

1. New Class Order exemption

ASIC could issue a new Class Order exemption from the advice provisions of the Corporations Act (Divisions 2, 3 and 4 of Part 7.7 of the Act) in relation to Provider Generated benefit projection statements provided certain criteria are met:

- The Class Order exemption applies to statements provided to existing members of superannuation funds (it does not exempt the licensee giving advice to a potential new member of a superannuation fund).
- The calculations in the statements are prepared using standard assumptions and technical guidelines as specified by the Australian Government Actuary.
- The statements meet certain minimum disclosure requirements.

We think it is particularly important that standard assumptions be used with Provider Generated benefit projection statements, as the users do not have the ability to alter the assumptions (like they do on a web calculator). Further, standard assumptions provide important consumer protection in ensuring that statements from different funds are provided on a comparable basis.

If this solution were adopted, it would be logical to amend Class Order 05/1122 to require the default assumptions on web calculators to be the same standard assumptions (where relevant) as those used for Provider Generated benefit projections.

2. Further clarification and Guidance

ASIC could issue written clarification (perhaps as amendments to existing Regulatory Guides) in relation to:

- Whether and when Provider Generated benefit projections are considered to be personal advice.
- Whether or not Class Order 05/1122 applies to Provider Generated benefit projection statements.
- How the "scaleable" obligation for having a reasonable basis for advice works in relation to Provider Generated benefit projections.

3. Modify Regulatory Guide 175 – Reasonable basis for advice

If it were decided that the Advice Provisions of the Corporations Act should apply in full to Provider Generated benefit projections (and therefore the statements must be provided as a statement of advice), then ASIC could confirm (as an amendment to Regulatory Guide 175) that the "scaleable" obligation to have a reasonable basis to the advice means that no inquiries need be made to individual members in relation to Provider Generated benefit projections.

Issue 2: Improving the Usability of Web Calculators by the Pre-population of Data

The Issue

Web based calculators are much easier to use if the member's own personal details (and the superannuation fund's own fees) are pre-populated into the calculator.

Prior to the introduction of the FSR provisions in the Corporations Act, many calculators were in fact pre-populated with members' data (and used the fund's own fee structure). However, the concern about the application of the advice provisions (and the calculators providing personal advice) saw most calculators with pre-populated data withdrawn and replaced by "generic" calculators (with no member data).

This trend was reinforced by ASIC Information Release on May 2004 (IR04-17) which stated some conditions that allowed calculators to be provided without a licence. In particular, two important conditions were:

- 'The calculator allows the consumer to alter **all** default settings for various assumptions'.
- 'Any default settings are based on **industry wide rather than fund specific** information'.

The issue was further complicated by ASIC's "Regulation Impact Statement for proposed Class Order 05/1122" (December 2005) which distinguished between "Fund Specific" (which used a fund's own fee structure) and "Generic". The "Regulation Impact Statement" suggested the class order only apply to "Generic" calculators.

Barriers

The final ASIC Class Order 05/1122 actually does not prevent:
- Calculators from being pre-populated with a member's own data.
- Calculators using a fund's own fee structure as a default.

(This was confirmed by an ASIC representative, speaking at the launch of the Institute's discussion paper on benefit projections and online calculators.)

However, misunderstanding remains in the industry and ASIC has not confirmed these opinions in a formal manner.

Solution

Further Clarification and Guidance

We suggest that ASIC issue further written clarification, confirming that calculators can still remain exempt from the advice provisions under Class Order 05/1122 if they:

- Can be pre-populated with member's own data.
- Can be pre-populated with a fund's own fee structure (including insurance premiums).

Issue 3: Level of Insurance Cover

The Issue

The Institute believes, for the following reasons, that the level of insurance cover taken out by many people would generally be regarded as inadequate in a holistic financial planning sense.

Firstly, it can be very difficult for many members to determine how much insurance cover they actually need. Given the cost of insurance cover, individuals do not want to take out excessive amounts of insurance.

Secondly, this decision is often complicated by the fact the some individuals will have their own personal policies outside of superannuation and may also have insurance cover provided in more than one superannuation fund.

Thirdly, insurance can be quite complicated, particularly disability benefits. It can be difficult to know exactly what is, and what is not, covered in various circumstances.

Solution

On-line calculators combined with appropriate educational material can be very useful in helping members to improve their understanding of the level of insurance cover suitable. The educational material covering this area should be prepared by appropriately qualified advisers and would ideally include generic case studies and common Q&As. However, engaging members using educational material alone has proven quite difficult. Some members still need further assistance to use the educational tools provided, which can be provided by access to an appropriately trained call centre. In this situation, call centre assistance is more likely to be focussed on helping members to navigate the on-line calculator and understand how it should be used.

Call centres can be a viable solution for some "simple advice", provided that:

- FSG's can be provided easily via a website.
- The Statement of Advice (SOA) requirements are simple and clear, including clear disclaimer requirements.
- There is a clear distinction between simple intra-fund advice and more complex situations that require professional advice.

An appropriate template SOA prepared and issued by ASIC could be adopted as an industry standard to reduce compliance costs.

Issue 4: Investment Option Choice

The Issue

A key investment option issue is "short termism", which includes helping members to understand investment risk/return trade-off and how that may impact on their level of income in retirement. There is no simple correct answer on what is the appropriate investment option choice and there can often be significant disagreement among professional advisers, particularly as the member approaches retirement age.

Altering the selected investment option on many web calculators to a more "aggressive" option will no doubt produce a higher likely projected retirement outcome for members. Yet, when the member's annual statement and other fund information shows a poor or negative return, members often question whether they should be in a different investment option.

Solution

This is a particularly difficult area for the provision of advice, whether it is intra-fund advice or not. Appropriately defined investment default options and educational material are a good starting point for trustees to help their members.

Beyond that however, it is very difficult to provide any further advice in this area without specialist expertise.

Issue 5: Disclosure of Fees and Costs

The Issue

When any professional advice is provided in respect of the appropriate investment option for members, the risk/return tradeoff referred to in Issue 4 above also needs to be considered taking into account the expected returns net of fees, costs and tax. However, obtaining and assessing the relevant fees and costs can often be very difficult.

Barriers

One of the barriers to such advice is that the current fees and costs disclosure regime does not require administration fees and costs to be disclosed separately from investment fees and costs. The current fees and costs template is:

(a) So rigidly focused on the disclosure of total fees and costs that it does not permit any logical separate disclosure of administration and investment costs; and

(b) Based on the disclosure of default option "management costs" and "other management costs" in such a way as to encourage the common practice of only quoting the range of (or maximum) "management costs" for other investment options.

Solution

In contrast, a fees and costs disclosure regime based on the separate disclosure of administration fees and costs from investment fees and costs would assist consumers by encouraging and enabling them to consider:

(1) The fund administration fees and costs (and the services provided for those fees and costs); and

(2) Separately, the investment fees and costs in respect of all the various investment options.

A further advantage that flows from the above proposal is that the confusing terms "management costs" and "other management costs" would no longer be required.

Splitting the fees and costs is consistent with the definition of "net earnings" in Corporations Regulation 7.9.01. Also, in the USA, new legislation was recently passed which requires 401k plans to separately show administration fees and investment management fees.

We believe that separation of administration fees and costs from investment fees and costs is not difficult. Trustees will usually know the investment component of fees and costs, or can make a reasonable estimate. In practice, we believe that many trustees will already be regularly making a subdivision of these costs as part of its normal internal supervision of the costs of operating the fund.

A key issue is that the split should be determined on a basis set by the trustee and applied consistently from year to year. Approval of the auditor could be required if considered necessary. We would be happy to offer further suggestions about this if required.

Issue 6: The Best Form of Contributions

The Issue

Whether to salary sacrifice or make after tax contributions is a relatively straight forward decision for most people given access to the right information, although it can be more complicated in some circumstances (eg. at income levels where the government co-contribution phases out).

Solution

A very simple on-line calculator combined with appropriate educational material can be very useful in helping members to determine which method of contributions is suitable for their circumstances, or whether they fall into a specific set of special circumstances which require individual professional advice. The educational material covering this area should be prepared by appropriately qualified advisers and would ideally include generic case studies and common Q&As. However, engaging members using educational material alone has proven quite difficult. Some members will still need further assistance to use the educational tools provided, which can be provided by access to an appropriately trained call centre. In this situation, call centre assistance is more likely to be focussed on helping members to navigate the on-line calculator and understand how it should be used.

Call centres can be a viable solution for some "simple advice", provided that:

- FSG's can be provided easily via a website.
- The Statement of Advice (SOA) requirements are simple and clear, including clear disclaimer requirements.
- There is a clear distinction between simple intra-fund advice and more complex situations that require professional advice.

An appropriate template SOA prepared and issued by ASIC could be adopted as an industry standard to reduce compliance costs.

Issue 7: Nominating Beneficiaries

The Issue

Despite the information that is already provided, some superannuation fund members still nominate beneficiaries that do not qualify under Superannuation Law or the fund's trust deed.

Some funds also allow members the option of either a binding or non-binding nomination. When members choose the binding option, the nominations lapse after 3 years and, despite being issued with reminders by their fund, some members do not update their nominations.

Solution

Appropriate educational material can be very useful in helping members to improve their understanding of who is eligible to receive a superannuation fund death benefit. The educational material covering this area should be prepared by appropriately qualified advisers and would ideally include generic case studies and common Q&As. However, engaging members using educational material alone has proven quite difficult. Some members still need further assistance, which can be provided by access to an appropriately trained call centre. In this situation, call centre assistance is more likely to be focussed on helping members to understand who is eligible to receive a superannuation death benefit and reminding members to keep their nomination up to date, particularly if it is a binding nomination. This type of information should be factual and it would be helpful if it was confirmed that it does not constitute financial product advice.

Call centres can be a viable solution for some "simple advice", provided that:

- FSG's can be provided easily via a website.
- The Statement of Advice (SOA) requirements are simple and clear, including clear disclaimer requirements.
- There is a clear distinction between simple intra-fund advice and more complex situations that require professional advice.

An appropriate template SOA prepared and issued by ASIC could be adopted as an industry standard to reduce compliance costs.

In our view, simpler intra-fund advice should not extend to the more complicated areas such as estate planning and advice regarding wills and legal structures.

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1 July 2009

The Manager
Superannuation Statistics
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Dear Sir/madam

Discussion Paper - Enhanced APRA superannuation statistics collections

The Institute of Actuaries of Australia (the Institute) is the sole professional body for actuaries in Australia. It represents the interests of over 1,500 Fellows and 2,000 other Members.

We appreciate the opportunity to provide comments on the above discussion paper, in relation to which there are five aspects on which the Institute would like to specifically offer some comments. These are:

1. Fund expenses or member fees and costs
2. Fees, costs and expense classifications
3. Fees and commissions – substance over form
4. Pension assets
5. Number of members or member accounts.

1. Fund fees or member fees and costs

For many funds the employer-sponsor bears some or all of the administration costs involved in operating the fund. Hence, the fees and costs borne by members may be different to the expenses paid by the fund. If the purpose of the enhanced statistics is to publish information to allow members to compare the administration fees and costs affecting their benefits relative to those of other funds, then the fee or cost information should be that which impacts on members' benefits, which is not necessarily equal to the expenses incurred by the fund.

For a defined benefit arrangement, for example, there may be no fees or costs being borne by members, yet if the statistics indicate that a defined benefit fund has a certain level of expenses (or worse still, if expenses are notionally allocated across members), there is potential for misunderstanding.

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2. Fees, costs and expense classifications

We note that Chapter 5 of the Discussion Paper is headed "*Achieving a better understanding of the non-investment drivers of member benefits*". We can appreciate and support the desire to separate "non-investment drivers" from "investment drivers" but we feel that the various proposals in Chapter 5 are inadequate.

As background we enclose copy of a 17 July 2008 submission that the Institute sent to the Financial Services Working Group relating to Intra Fund Advice. Issue 5 (page 9) of that submission relates to the disclosure of fees and costs and recommends the separate disclosure of <u>administration</u> and <u>investment</u> fees and costs.

Page 9 of our submission explains that a fees and costs disclosure regime based on the separate disclosure of administration fees and costs from investment fees and costs would assist consumers by encouraging and enabling them to consider:

(1) The fund administration fees and costs (and the services provided for those fees and costs), and

(2) Separately, the investment fees and costs in respect of all the various investment options.

Note that (1) and (2) above are usually at different levels; the former is usually at the fund level and the latter is usually at investment option level.

In Chapter 5 of the current discussion paper, APRA puts forward six proposals under the heading "Fees". We would place the separation of administration fees, costs and expenses from investment fees, costs and expenses well ahead of all of the current proposals. One reason for this is that such separation would itself assist the effectiveness of the first five current proposals.

We believe that the separation of administration fees, costs and expenses from investment fees, costs and expenses requires joint and coordinated action by both APRA and ASIC so that the separation applies <u>for all purposes</u>, including:

(a) PDS disclosure of fees and costs,
(b) Ongoing disclosure of member fees and costs in periodic statements,
(c) Annual disclosure of plan fees and costs in fund annual reports, and
(d) APRA expense statistics.

We are aware that the current APRA statistics require the separation of "Operating Expenses" from "Investment Expenses" and, very relevantly, that many funds have been incorrectly reporting items, or not reporting at all, items within these two classifications. This is because there has been no coordinated action on (a) to (d) above and also, we suspect, because the split is not required for any other purpose.

Unless some coordinated action is initiated, we expect that the current classification problems will continue and many of APRA's planned enhancements will be frustrated and ineffective.

3. Fees and commissions – substance over form

Chapter 3 of the discussion paper states:

"APRA seeks comments on the feasibility of collecting data at the investment option level on the aggregate amount of fees and commissions paid to financial planners or investment advisors in respect of members. As a minimum, APRA expects that it would be feasible to collect the number of members in respect of whom such fees or commission is paid."

We are puzzled about two aspects of this.

Firstly it implies that members bear the cost of both fees and commissions separately. However, in some cases, the product provider may pay a commission to a financial adviser and the cost of this is allowed for indirectly in the fund's overall fees charged to members. In other words, the cost of commissions is sometimes already allowed for within the fee structure – in which case members only bear the cost of fees. To "aggregate" fees and commissions paid could therefore involve double-counting.

Secondly, we do not see the difference, in principle, between:

- Plan A which is a Retail fund with asset-based fees where financial planners or investment advisors receive commissions for securing and enrolling employers or members, and

- Plan B which is a not-for-profit fund with dollar-based fees where 'internal' financial planners or investment advisors (or marketing staff or development officers) receive bonuses, other incentives or salary promotion increases for securing and enrolling employers or members and the fund covers such costs (and probably other costs) by a deduction from crediting rates or unit prices.

We suggest that the intention should be to treat both funds equally for statistical and disclosure purposes. Therefore, the focus should only be on amounts charged directly to members.

Further, to reflect these issues and the issue in 2. above, we suggest that fees and costs be separated into:

(i) investment fees and costs (as, effectively, already defined in Corporations Regulation 7.9.01),
(ii) administration (or operating) fees and costs which could include advice costs which are not covered by specific advice fees, and
(iii) specific advice fees

for all the purposes identified in 2 (a) to (d) above.

4. Pension assets

Chapter 3 of the discussion paper also states:

"APRA proposes collecting data on whether the fund includes pensioner members, and whether these are maintained in separate sub-funds or integrated with, but accounted separately from, contributing members. For those funds that include pensioner members, APRA proposes collecting data on commencing and continuing pensioner members classified by age, member balance and asset allocation."

We suggest that this proposal should include data on year-end asset values for each type of post retirement pension (including allocated pensions, account based pensions, fixed term pensions, life expectancy pensions, market linked pensions, transition to retirement pensions, defined benefit lifetime pensions etc). In particular in Appendix 1, Part 1 – indicative tables, Table 1 sub fund detail – the "classification of sub fund type" should be further divided between various pension types.

As the superannuation system matures, this would provide invaluable information for taxation and retirement income policy and social security purposes (especially if the aggregate results are published in the Annual Superannuation Bulletin.

5. Number of members or member accounts

One issue that is worth considering is the difference between the "number of members" and the "number of member accounts" and this is not identified in the paper (apart from the reference to the number of member-protected accounts). Because members often have accounts in more than one fund or more than one account in a fund, the number of member accounts is approximately twice the number of members.

Greater clarity and guidance on this issue would assist both those responsible for supplying statistical inputs and those endeavoring to interpret statistical outputs.

(Some of the issues raised in this letter also impact on the responsibilities of the Australian Investments and Securities Commission. Would you please confirm that it would be in order for us to send them a copy of this letter?)

If required, we would be very happy to further explain or discuss these five issues with you. Please do not hesitate to contact the Chief Executive, John Maroney on (02) 9233 3466 (john.maroney@actuaries.asn.au) in this regard, or for any further information.

Yours faithfully

Trevor Thompson
President

C. R. Grenfell ... R. J. Stevens

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4 November 2009

Super System Review
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Dear Sir/Madam,

DISCLOSURE OF SUPERANNUATION FEES AND COSTS

We are both Melbourne-based actuaries with many years experience in superannuation, including work for industry, corporate, government, retail, master and eligible rollover funds. Over the years we have regularly participated in consultations with Government authorities either as representatives of industry bodies or on our own behalf.

Section 8.2.3 of the Super System Review phase two Issues Paper asks:

> Is there a way of boiling fees and charges down to a small number of distinct types (using mandated naming conventions) so that members could make useful comparisons between funds? …
>
> … could ASIC's enhanced fee disclosure regime be improved in any way to help members understand and compare fees between funds?

We believe that the emphatic answer to each of these questions is **"yes"**

Our view is that the current disclosure regime is ineffective and confusing and does not adequately assist consumers to compare the costs of different funds – in fact in many situations it is potentially misleading. We agree with the officials from APRA who reportedly told the Parliamentary Joint Committee on Corporations and Financial Services in 2007 that:

> … putting a man on the moon might be easier than finding comprehensive information on superannuation costs, fees and charges.

However we also believe that this matter can be rectified and enclose a summary of our proposal, entitled the "Way Forward", for your consideration. We recommend that it should be subject to rigorous consumer testing to confirm its suitability and to identify further improvements.

Note that **under our proposal consumers do not have to examine and understand each individual fee or cost reducing their account balance**. The material a fund must issue would demonstrate the combined effect of the non-investment fees and costs over five periods for two standard contribution levels. This provides a sound and simple basis for a comparison of these fees and costs for two or more funds the consumer is interested in.

Investment fees and costs do not normally need to be examined over more than a single year to achieve a sound comparison, but separate figures are required for each investment option.

Some critics have suggested it would be easier for consumers if the effect of fees and costs could be compared using a single combined figure for investment and non-investment fees and costs instead of separate figures for these two components. While that would be "easier" it is just not possible to do this on a sound basis.

Even some Government representatives have used a single percentage to illustrate fee and cost levels without explaining what the percentage applies to and how it is fair to accounts and contribution levels of all sizes, all investment options, and all superannuation vehicle structures.

As explained in Section 11.3 of the Super System Review phase two Issues Paper, the Financial Services Working Group (FSWG) is currently considering a *"worked example which will provide members with a single figure; expressed as a dollar amount and as a percentage."* The five members of the of the Institute of Actuaries Benefit Projections Working Group (of which we are members) have written to the FSWG about this proposal and have explained why this "overall percentage cost" methodology is unsound.

We would welcome the opportunity to discuss our proposal with you.

Yours sincerely,

Colin Grenfell and Ray Stevens

Standardised Disclosure of Fees and Costs - the Way Forward

[Updated November 2009]

The first version of this note was published in the August 2003 edition of *Actuary Australia*, the monthly magazine of the Institute of Actuaries of Australia. To take into account refinements suggested by various industry participants an updated version was published in the May 2004 edition of that magazine and another was included in our April 2007 submission to the Parliamentary Joint Committee on Corporations and Financial Services. For this November 2009 update we have incorporated some changes resulting from the work of the Institute of Actuaries Benefit Projections Working Group (of which Colin Grenfell and Ray Stevens are members) for its submissions to ASIC on benefit projections.

To help consumers compare different superannuation plans and products requires some standardisation in the way that fees, charges and costs are disclosed in Product Disclosure Statements (or PDS's). In fact, the same can be said of any product with an investment component, such as a managed fund or a life office or friendly society investment-linked policy or bond.

Just over ten years ago, Colin Grenfell wrote an article "KFS Disclosure - no easy matter" which was published by the Association of Superannuation Funds of Australia (ASFA) in the December 1998/January 1999 edition of SuperFunds. The article summarised the then public views on fee disclosure as expressed by the Liberal-National Coalition, the Labor Party, the Australian Securities and Investments Commission (ASIC), the Industry Funds Forum and others.

The article also noted that the Institute of Actuaries of Australia recommended that:

(1) Investment performance should be reported net of tax and investment transaction costs and net of all investment costs.

(2) Key Features Statements should include a brief description of all fees and charges.

(3) In addition there should be some form of analysis of the impact of fees and charges which should focus on all non-investment fees and charges.

(4) The impact of these fees and charges should be shown net of employer subsidies but should include any costs in excess of fees and charges which impact on members' benefits.

The authors of this note believe that these four recommendations reflect sound principles that remain valid today.

The authors note that the Institute's principles include the need to show separately the effect of investment fees and costs and of non-investment (or broadly administration) fees and costs. The authors consider this split is essential for a sound comparison of funds. The split also facilitates member investment choices. It is noted that the Report commissioned by ASIC from Professor Ian Ramsay, released in September 2002, recommended that investment and administration fees should be separated. Investment fees and costs would be defined consistent with Corporations Regulation 7.9.01 which refers to "… relating to the management of investment of fund assets".

In our previous work we have referred to non-investment fees and costs as “administration” fees and costs. The early material issued by the Cooper Review seems to have expressed a preference to call these non-investment fees and costs “superannuation” fees and costs rather than “administration” fees and costs. This is an innovative and very appropriate proposal which we support provided the new terminology is mandatory and clearly specified in regulatory guidance and/or legislation. We have therefore amended the terminology in this update to allow for this preference.

The August 2003 and May 2004 articles explain the background and relevant events since 1998. A further article in August 2005 expands on recommendations (1) and (3) above.

What happens next?

We suggest that the way forward should include the following three level fee and cost disclosure framework:

1. At a glance

This component of the framework would summarise the existence of various fees and costs using standardised terminology, order of contents and grouping. For example;

INVESTMENT		SUPERANNUATION	
Ongoing fees	***Yes***	Initial fees	***No***
Ongoing extra costs	***Yes***	Ongoing fees	***Yes***
Switching fees	***Yes***	Ongoing extra costs	***Yes***
Buy-sell spread	***Yes***	Benefit fees	***Yes***
		Exit fees or penalties	***No***

OTHER		
	Any other fees or costs?	***No***
	Are any dollar fees indexed	***Yes***
	Are fee rates expected to increase in the next 5 years?	***No***
	Are some tax deductions withheld?	***No***

2. Brief description

This component would be similar to the brief descriptions of fees and charges used in Member Booklets and some PDS's, but there would be a few important constraints. For example;

- Must include brief descriptions of how each of the above "***Yes***" responses is calculated and charged.

- Must start a new paragraph for each fee or cost.
- Must be in the same order as the first component and use the same grouping.
- Must briefly describe the services provided.
- Must use standard terminology similar in style and depth to the requirements of Corporations Amendment Regulations 2005 (No. 1) but, primarily as a consequence of the separation of fees and costs into "investment" and "superannuation" components, without the unnecessary and confusing terms "management costs" and "other management costs".

3. Impact of fees and costs

This third and final component would replace the current Corporations Regulations "example of annual fees and costs". Like the current example it would exclude service fees. It would have two distinct parts, one for Investment fees and costs and one for Superannuation fees and costs. For example;

INVESTMENT

For each investment option, list:

(a) the ongoing net of tax fees and extra costs as a single annual dollar amount per $10,000 of average assets (eg. if fees were .44% net of tax and the only other investment costs were Consultant's fees of .09% net of tax, then list $53 per annum for this option), and

(b) the buy-sell spread (if any) and state whether this margin is paid to the fund manager or left in the fund for the benefit of other members.

SUPERANNUATION

A standardised superannuation fees and costs projection (similar to that now required in the United Kingdom) for at least two levels of contributions. This is probably the most important part of the framework.

This part includes the following five columns for initial annual contributions of $5,000 and $10,000 respectively:

(1)	At end of years	2, 5, 10, 20 and 40
(2)	Total paid in to date	3 or 4 significant figures
(3)	Account balance without fees and costs deducted	3 or 4 significant figures
(4)	Effect of fees and costs to date	2 or 3 significant figures
(5)	Account balance with fees and costs deducted [= (3) - (4)]	3 or 4 significant figures

The Institute of Actuaries of Australia's 6 November 2008 response to ASIC Consultation paper 101 suggested, in its answer to Question 4 in Section B5 (page 30 of the response), how the two contribution levels in 3. above should be determined from time-to-time. The Institute suggested that they should be based on the future SG rate (and any soft compulsion rate of member contributions) applied to say 75% and 150% of an average weekly earnings figure (annualized) with the resultant annual contributions rounded to the nearest $1,000 and $2,000 respectively. For example, if average weekly earnings were $1,300 and the SG rate were 9%, then:

- Lower standard contribution = $1,300 x 0.75 x 52 x 9% = $4,563 = $5,000
- Higher standard contribution = $1,300 x 1.50 x 52 x 9% = $9,126 = $10,000

Sample Product Disclosure Statements

Two sample Product Disclosure Statements, which reflect the principles that we consider should apply to fee and cost disclosure, have been prepared and can be supplied if required. One sample is for a hypothetical Retail superannuation fund and the other is for a hypothetical Industry plan named "ZIS". (They have not been updated to reflect legislative or taxation changes since 2004.)

The next page is an extract from the latter PDS to illustrate the third component of our recommended framework.

This extract has been updated to amend the terminology for non-investment fees and costs from "administration" fees and costs to "superannuation" fees and costs and to use initial contributions of $5,000 and $10,000 as determined above.

We consider that if our proposal is adopted, the Australian Government Actuary should be given the responsibility of setting and monitoring the superannuation fee and cost projection basis.

We draw to your attention the following three important features of "Table 5":

- The first three columns would be common to all funds (when making a comparison of two or more funds, this feature gives the reader confidence that they are comparing "like with like").
- The fourth and fifth columns are unique to each fund since they depend directly on each fund's superannuation fees and costs.
- The fourth column shows that after 2 year's the effect of fees and costs (for ZIS) for a $10,000 initial annual contribution is **115%** of that for a $5,000 initial annual contribution but after 40 year's the effect of fees and costs for a $10,000 initial annual contribution is **191%** of that for a $5,000 initial annual contribution (this large relative difference demonstrates why with any comparator it is essential to have results for both short and long durations and for at least two contribution levels).

Colin Grenfell and Ray Stevens

[extract only]

Table 4: ZIS Annual INVESTMENT Fees and Costs Summary per $10,000 account balance in each investment option			
	Option A	Option B	Option C
Ongoing (and Extra)	$161	$140	$124
Buy-sell spread	Nil	Nil	Nil

Assumptions on which the following fee table is based

The table below uses the standard assumptions about account balance, contributions and investment returns that all funds must use to show the impact of their superannuation fees and costs. These assumptions are as follows:

- Account balance at start: nil.
- Initial Annual Employer contributions of $5,000 or $10,000 (before tax).
- Contributions payable mid-year (or say weekly) and increasing by 4.5% each year.
- Member contributions: nil.
- Net annual investment return of 7% (net of tax and net of investment fees and costs).
- Dollar fees increase by 3% each year.
- Results in **"today's dollars"** (ie deflated using a salary increase assumption of 4.5% each year) .
- No allowance for any tax payable on benefits.

Table 5: Effect of ZIS SUPERANNUATION Fees and Costs				
If withdrawn	Total Paid in to date	Account Balance without fees and costs deducted	Effect of fees and costs to date *	Account Balance with fees and costs deducted *
	Initial Annual Contribution $5,000			
after 2 years	$ 10,000	$ 8,700	$ 130	$ 8,570
after 5 years	$ 25,000	$ 22,560	$ 420	$ 22,140
after 10 years	$ 50,000	$ 47,940	$ 1,260	$ 46,680
after 20 years	$100,000	$108,700	$ 4,700	$104,000
after 40 years	$200,000	$283,000	$22,500	$260,500
	Initial Annual Contribution $10,000			
after 2 years	$ 20,000	$ 17,400	$ 150	$ 17,250
after 5 years	$ 50,000	$ 45,120	$ 610	$ 44,510
after 10 years	$100,000	$ 95,880	$ 2,080	$ 93,800
after 20 years	$200,000	$217,400	$ 8,500	$208,900
after 40 years	$400,000	$566,000	$43,000	$523,000

* The fees and costs include all fees and costs, except investment fees and costs and insurance charges. They include the benefit payment fee. For ZIS there are no other surrender penalties or exit fees and ZIS does not pay any commissions.

The last line of Table 5 (for an annual contribution of $10,000) shows that over a 40 year period the effect of the total deductions could amount to $43,000 (in today's dollars). Putting it another way, this would have the same effect as bringing investment returns down from 7% a year to 6.63% a year.

C. R. Grenfell FIA FIAA FASFA ABN 87 774 479 685

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12 August 2010

Mr Ross Jones
Deputy Chairman
Australian Prudential Regulation Authority
400 George Street (Level 26)
Sydney NSW 2000

Dear Sir,

Superannuation Crediting Rates and Investment Returns

This letter has been prepared by the six members (Colin Grenfell, Bill Buttler, Glenn Langton, Andrew McRae, Richard Starkey and Ray Stevens) of the Institute of Actuaries of Australia Benefit Projections Working Group (BPWG). The BPWG has responsibility for benefit projections, disclosure and advice matters for the Institute.

The letter is prompted by your 29 June 2010 Letter to Trustees of APRA Regulated Superannuation Funds concerning "Investment Risk Description".

We note that the guidance set out in the attachment to the above letter suggests that Trustees should ensure that "for each strategy offered, it is clearly stated what the frequency of negative returns of that strategy is over a 20 year period". However we also note that no guidance is given about how to calculate these "returns".

Before a Trustee can estimate the probability of a negative return for an investment option, the Trustee must know whether the estimate relates to:

1. the investment return net or gross of investment fees and costs; or
2. the investment return net or gross of asset- related fees and costs; or
3. the rates credited to members' accounts or the net earning rate of the assets supporting the investment option.

These issues can have a major impact on the probability of a negative return. It is therefore imperative to have a clear definition of how "investment performance" is to be calculated before any estimate of the probability of negative returns can be determined.

The following is an extract from the Institute of Actuaries of Australia's second submission to Phase two of the Review into the Operation and Efficiency of the Superannuation System:

Institute of Actuaries of Australia - 14 December 2009
Review into the Operation and Efficiency of Australia's Superannuation System

8.2.10 Research houses

Are super fund members adequately served by the research on super funds generally available? Could research houses be improved to better serve the needs of members? Do research houses have enough staff and resources to do meaningful analysis of all available data? Should they be allowed to report performance on a monthly basis that is not audited and subject to a range of assumptions, including estimates of tax payable? Should research houses in super be required to hold higher levels of training and skills than is currently the case? Are the current fee arrangements used by research houses sufficiently free of conflicts? Are the arrangements properly understood by members? Should research houses be required to disclose all commercial arrangements that they (or related parties) have with the funds being rated?

We are concerned that Research Houses and many superannuation funds are not reporting and comparing "like-with-like". From 1 July 2009, superannuation funds will be required to report long-term returns prominently in periodic member statements.

There are three main issues that we feel need to be clarified when reporting long term returns. In particular, whether returns should be:

- Shown net or gross of administration fees and costs (which may be deducted from the investment return or built into a fund's unit prices and therefore impact on returns),
- Including or excluding adjustment to returns for the changes in reserves, and
- On a time weighted or money weighted basis.

Essentially these issues relate to the differences between "crediting" and "earning" rates. These issues are not new (they were unresolved prior to the introduction of disclosure of long term returns), but the new reporting requirements provide an opportunity to clarify them.

The "crediting" (or allotments to member accounts) might be via crediting rates or via unit prices. This makes no difference to the issue under consideration. The issue applies in both situations and it applies to all accumulation and hybrid superannuation funds, but not to defined benefit interests.

The following table summarises the key differences between "crediting" and "earning" rates:

	Crediting Rates	**Earning Rates**
(1) Fees and Costs	Net of investment fees and costs <u>and</u> net of asset-based administration fees and costs	Net of investment fees and costs only. Corporations Regulations 7.9.01 defines these as "charges relating to the management of investment of fund assets".
(2) Reserve Movements	Crediting rates are reduced by transfers to reserves and increased by transfers from reserves. The reserves might be general-purpose contingency reserves or operational reserves to cover fluctuating expenses or investment "smoothing" reserves.	Earning rates are not net of reserve movements. They reflect the fund's or sub-fund's investment return which is unrelated to reserve movements.
(3) Weighting	In the past have usually been "time" weighted.	In the past have usually been "money" weighted.

(4) Reporting prior Corporations Amendment Reg 2009 No.3	Crediting rates or amounts in periodic member statements. Information about reserves (Corporations Regulations 7.9.37 (k), (l) and (m)) in plan annual reports.	Five year annual earning rates and average earning rate (Corporations Regulations 7.9.37 (j)) in plan annual reports.
(5) Reporting after Corporations Amendment Reg 2009 No.3	As above.	Five year and, after 1 July 2010, ten year average earning rates in or with periodic member statements. We anticipate that these will usually be "time' weighted.

We consider that the differences between "crediting" and "earning" rates are logical and that the Corporations Regulations requirements are appropriate and sound.

Our prime concern is that differences (1) and (2) above are not recognised by Research Houses and by most funds and most advisors. If this is true then consumers are not comparing "like with like". They are being misled. This may lead to compliance problems and likely confusion as funds move into the detailed implementation of the new requirements.

We feel that some guidance is required from the regulator about how differences (1) and (2) should be communicated to members.

We note that the Final Report of the Review does not refer to the above issue – so it remains unresolved.

Would you be agreeable to a meeting or conference phone call to discuss this? All the members of the BPWG reside in Melbourne or Sydney.

We are conscious that the issues raised in this letter are also of interest to the Australian Securities and Investments Commission. For your information we have therefore enclosed copy of a similar letter sent to ASIC today.

If you would appreciate further explanation or background, please do not hesitate to contact me.

Yours sincerely,

Colin Grenfell
Convenor, Institute of Actuaries Benefit Projections Working Group

30 July 2010

Ms Chloe Youl
Lawyer
Strategic Policy
Australian Securities and Investments Commission
GPO Box 9827
Melbourne VIC 3001

email: policy.submissions@asic.gov.au

Dear Chloe

Superannuation Forecasts: Inclusion of Age Pension

The purpose of this joint submission from the Institute of Actuaries of Australia (The Institute) and The Association of Superannuation Funds of Australia (ASFA) is to explain how the age pension can be allowed for and included in superannuation forecasts in a manner which is easy for funds and plan sponsors to implement.

Both the Institute and ASFA, as well as many other superannuation associations, support the view that the age pension should be included in superannuation forecasts.

This submission is based on the Institute's submission of 16 December 2009 in response to ASIC Consultation Paper 122.

In that submission it was stated:

> For many superannuation fund members, the age pension will be an important part of their post retirement income. For these members, any consideration of the adequacy or otherwise of their income in retirement without having regard to the age pension is meaningless. Therefore we believe that it is important that some reference to the age pension be included with the retirement projection.
> …
>
> We disagree with the statement in RG000.53 that the age pension is very difficult to take into account in a retirement projection. It is arguable that by including the Age Pension there is in fact less uncertainty in the retirement projection than producing a forecast based on superannuation alone.
> …
>
> …, the Institute has provided a suggested mandatory approach to projecting the age pension for a member in our submission on CP101. We draw to your attention that this does **not** require funds to seek information about marital

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status, residency, other assets etc. The basis is challenging for the Australian Government Actuary to specify but **not** difficult for individual funds to apply.

We acknowledge that including the Age Pension on mandatory retirement projections statements introduces a risk that members total the results from two or more projection statements and double up on the Age Pension component of their retirement income. Our sample hypothetical projection statement, on pages 49 and 50 of our 6 November 2008 CP 101 submission, has a specific warning about this.

An updated version of pages 49 and 50 of the Institute's CP 101 submission is enclosed. These two pages are put forward for discussion purposes only. They are not technically final and certainly require extensive consumer testing and further modification.

We are aware that the Cooper Review into the Operation and Efficiency of Australia's Superannuation System is also considering mandatory superannuation forecasts, with its MySuper proposals. Our strong preference for including the age pension applies equally with those proposals.

All the preceding has been included by way of background. We would now like to turn to a specific recommendation which we consider is a critical component to enable funds and plan sponsors to implement inclusion of the age pension in a straight-forward and efficient manner.

Specific Recommendation

We believe that, ,based on specified assumptions, a table which shows for each level of superannuation income (in today's dollars), the corresponding combined income including the age pension can be established.

For each retirement age we envisage that the table would have columns of figures under three headings such as:

(a) projected superannuation income (in today's dollars), and
(b) the corresponding age pension (also in today's dollars), and
(c) the corresponding combined income (i.e. (a) plus (b)).

The table would be based on carefully considered and specified assumptions similar to those specified on the second page of the enclosure – and reproduced here for convenience:

Age Pension

We have assumed that you satisfy the Australian residency requirements to qualify for the Age Pension and that the current rules for the Pension remain unchanged. From September 2009 the maximum Age Pension including the Pension Supplement is $13,741 pa each if you have a partner and $18,229 pa for singles. Eligibility for the Age Pension is subject to an asset test and an income test. We have assumed that at age 65 you will own your home and have no assets or income affecting your Age Pension, other than your BC Superannuation Fund retirement benefit. It is assumed this benefit will be used

to purchase an account-based pension. **Based on this, we have estimated your Age Pension, allowing for a possible reduction due to the assets test or income test applying because of your super**.

We have also assumed that you will receive the couple rate of age pension and that your partner has the same super balance as you – but their Pension income is not shown. Your actual Age Pension may be different from what we have estimated; it will depend on your relationship status, your assets and income and that of your partner if you have one.

We propose the most appropriate resource to carry out this work would be the Australian Government Actuary, being technically capable, independent, and experienced in providing technical and related policy advice to support the supervision of the financial services sector.

It will be evident from the above that the Australian Government Actuary would need to review the table whenever the age pension is updated or age pension eligibility rules are varied. We recommend that ASIC discuss the production of such a table with the Australian Government Actuary.

Clearly, when the process has been established to produce the table described above, it could be extended, for example, to change the assumption of being part of a couple to that of being single.

We would of course be very pleased to discuss this letter further with you, and to assist in any way possible with implementation of our recommendation.

When it comes to the implementation stage of our recommendation, we consider that the industry will need an appropriate lead time for full compliance of at least 2 years.

Please do not hesitate to contact either Melinda Howes, as the Chief Executive Officer of the Institute (Phone:(02) 9239 6106, email: melinda.howes@actuaries.asn.au) or Andrew Boal, Convenor of the Institute's Superannuation and Employee Benefits Practice Committee (Phone:(03) 9655 5103, email: andrew.boal@towerswatson.com) in this regard, or for any further information.

Yours faithfully

Melinda Howes and Pauline Vamos

Melinda Howes	and	Pauline Vamos
Chief Executive Officer		Chief Executive Officer
The Institute of Actuaries of Australia		The Association of Superannuation Funds of Australia