



Financial System Inquiry Final Report
Cbus Super - Submission to Government in Response
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Introduction

Cbus (United Super Pty Ltd) provides superannuation services to construction, building and allied industry workers and retirees, their families and their employers. Cbus was established in 1984 and is one of Australia's oldest industry superannuation funds.

The fund has more than 700,000 members and 90,000 employers and has funds under management valued above \$30 billion.

Cbus operates on a profit-for-members basis. All returns are used for the advantage of fund members and there are no dividends paid to stakeholders.

We note the significant contribution of Industry Super Australia (ISA) and the Australia Institute of Superannuation Trustees (AIST) to the Inquiry process and we adopt and support their broader submissions.

We also recognise the analysis and logic inherent in the Members' Equity Bank submission and adopt and support their recommendations to Government regarding resilience and competition in the Australian banking sector.

Cbus welcomes the recognition by the Inquiry of the importance of superannuation and retirement income and would express support and alignment with much of the report, especially around retirement solutions.

However, we question the logic of some of the recommendations that seek to impose unwarranted changes to sectors of the system that have performed strongly over a long period time.

Importantly, the Report acknowledges the vital role superannuation plays now and the increasing role it will play in the future in not only providing Australians with retirement income but in providing productive capital to the Australian economy.

Much more can be done in the investment of productive capital, looking at long-term investment in Australia's and the world's economy, in sustainable and socially constructive assets. However, subjecting the superannuation system to continued regulatory change, particularly where there is no evidentiary basis for such change, may have the undesired effect of tempering such activity.

The Report raises significant and important decisions for the Government and the Australian people. In response, the Government should weigh the recommendations of the Inquiry against the evidence presented and resist short-term or ideological policy decisions.

Cbus does not seek to respond to Government about the whole of the Report or all of its recommendations, instead providing comment on specific and immediate areas of interest to the Fund and its membership.

FSI Recommendation 8

Remove the exception to the general prohibition on direct borrowing for limited recourse borrowing arrangements by superannuation funds.

Cbus supports this recommendation on the basis of the argument put forward by the Report's authors, namely that the purpose of superannuation is to save to fund retirement and leveraging superannuation can place savings at risk and potentially increase the burden on tax payers.

By and large, limited recourse borrowing by superfunds is undertaken in the Self Managed Superannuation Funds (SMSF) sector for the purposes of purchasing assets such as property. We concur with the Inquiry's observations that this can concentrate Fund assets thereby increasing risk.

This recommendation sits neatly with the following recommendation of gaining consensus and enshrining in legislation the objectives of the superannuation system.

If, as suggested by the FSI Report, the overarching purpose of superannuation is to "provide income in retirement to substitute or supplement the Age Pension" then leveraging superannuation savings should be prohibited.

Likewise, Cbus' submission that a broader purpose be applied to the whole retirement system policy framework through an objective of: "Deliver a comfortable retirement to all Australians", would equally rule out the risks associated with leveraging to individuals and the system as a whole.

APRA regulated Funds such as Cbus, are prohibited from borrowing inside the Fund – with the exception of limited borrowing where it is required to meet short-term liquidity requirements and we welcome the Inquiry findings that these settings should remain as they are.

FSI Recommendation 9

Seek broad political agreement for, and enshrine in legislation, the objectives of the superannuation system and report publicly on how policy proposals are consistent with achieving these objectives over the longer term.

Cbus supports the intent of this recommendation.

The superannuation system is highly regulated, as it should be given its compulsory nature and taxation concessions, and subject to much regulatory change. Such change often demands time and resources to implement which equates to costs to superannuation members.

Successive governments have recognised change fatigue amongst the broader public around superannuation rules and have undertaken not to change regulations only to then implement significant changes.

That is the prerogative of government, however, there is a need for policy proposals to be measured against whether they are aligned with an agreed and enshrined purpose.

The Report recommends that the Government should seek support for the primary purpose of superannuation as being:

“To provide income in retirement to substitute or supplement the Age Pension.”

It should be noted that the compulsory superannuation system is already lifting the pressure off the government’s pension obligations by as much as \$6 billion a year.¹

This is a laudable objective and one that could certainly sharpen the policy proposal debate around superannuation. For example, current matters of public debate such as whether superannuation should be more ‘flexible’ and be accessed by people for the purposes of entering the housing market or other reasons could be carefully measured against the overall purpose or objective. And it recognises the interplay between the various retirement income pillars.

This last point is very important. Australian’s retirement income is based on three pillars – superannuation, the Age Pension and personal savings – and they do interact with each other through regulation.

Because of this, while agreeing with the intention of the Inquiry’s recommendation, Cbus submits that a more aspirational and broader purpose statement could be adopted against which the whole of retirement system policy proposals can be measured.

This would include, but not be limited to, Age Pension policy, the taxation system, superannuation regulation, health and aged care policy.

Together with Industry Super Australia, we would propose that a single retirement policy objective be to: Deliver a comfortable retirement to all Australians.

The objective measure for this could draw from the well-established ASFA comfortable retirement income standard.

In raising the bar and broadening the objective beyond superannuation providing income in retirement substituting or supplementing the Age Pension, the purpose not only provides a wider, strategic focus for policy-makers but a higher onus on industry participants consistent with many of the FSI Report’s further recommendations.

¹ Estimated by Industry Super Australia

For example, by adopting the broader objective and focussing on retirement outcomes, the response from industry must not simply be on maximising accumulation but on structuring retirement phase products that assist in delivering the objective.

FSI Recommendation 10

Introduce a formal competitive process to allocate new default fund members to MySuper products; unless a review by 2020 concludes that the Stronger Super reforms have been effective in significantly improving competition and efficiency in the superannuation system.

Cbus does not support the recommendation.

Cbus welcomes the recognition by the FSI Report that the Stronger Super reforms have yet to become fully operational, with the transfer of default members from current investment options to a MySuper option not mandated to occur fully until 2017.

We also welcome the significant shift in the Report from a full emphasis on 'lowest cost' to a 'net benefit' criteria. This is significant because a single focus on cost alone could certainly be detrimental to fund performance, retirement income savings and certain asset class investment, including infrastructure investment.

Indeed, this is an area that the Government needs to think through very clearly. The current modern award default fund system is providing good outcomes to members and to the broader economy through investments in long-term assets such as public infrastructure.

It is, therefore, somewhat perplexing that the Inquiry Report seeks to tackle perceived problems in the default environment rather than in the retail 'choice' environment where much of the drag is evident in the system from higher fees and lower performance.

The superannuation system is still maturing and, as it does so and funds reach a larger scale, lower cost outcomes will be realised particularly in investment management.

The industry fragmentation that the Report highlights will consolidate as smaller funds find their lack of scale locking them out of certain asset investment, lowering performance, and unable to contain costs.

Again, the important measure of any policy recommendation must be what is in members' best interest – and the overarching role of the superannuation system should consensus on one be reached and it be adopted.

Simply assuming MySuper accreditation provides a robust safety net or quality filter to qualify as a default has, rightly, been rejected by the FSI as it was by the Productivity Commission.²

² Productivity Commission 2012, Default Superannuation in Modern Awards, Report no. 60, Final Inquiry Report, Canberra

The Productivity Commission accepted the need for a higher quality filter for default funds stating:

“The Stronger Super and related reforms provide an effective foundation to promote disclosure and comparability of default superannuation products and funds but, given the uncertainty surrounding the likely number, mix and quality of MySuper products there needs to be a ‘quality filter’ to distinguish amongst them.”³

The history of Cbus, and industry superannuation funds generally, is that they were established and continue to operate as part of the industrial relations landscape. Superannuation is the deferred wages and, therefore, consumption of employees.

In recognition of this, industry funds such as Cbus were created as all-profit-to-member funds, run only to benefit members, focused on delivering value-for-money outcomes and rejecting commissions and other cost imposts that would erode those deferred wages.

By all measures, the not-for-profit model of superannuation has outperformed its competition over the short, medium and long term. The McKell Institute recently found that not-for-profit funds outperformed for profit funds across a 25 year period, based on average returns, by about 1.84% per year.⁴

The Cbus investment default fund, Growth (Cbus MySuper), is ranked in the top quartile of the SuperRatings SR50 Balanced Funds performance index for net average annual returns across 1,3,5,7 and 10 year periods

This is very important in the context of default selection. Those who do not make a choice for themselves in regard to their super rely on others. They rely in part on their employers, who may be ill-equipped to choose but who want to be assured that they are making good decisions on behalf of their employees, deserve the highest quality default funds. The Fair Work Commission process, industrial bargaining, and product regulation (MySuper) all play some role in ensuring that those who do not choose are defaulted into a high quality fund. The Fair Work Commission and enterprise bargaining have clearly worked well. The efficacy of MySuper in protecting people remains to be seen, though the FSI Report was not confident it would work well.

Industry funds have performed well as default funds. The affinity with industry, the intimate specialist knowledge of: the labour force; labour mobility; the capacity of employers to manage payroll and other systems; employee financial literacy; insurance needs and investment preferences; are the hallmarks of genuine industry funds overseen by employees and employers and their peak bodies.

Indeed, the Report notes that a national auction process for defaults could have:

³ Ibid pg.130

⁴ The McKell Institute, The Success of Representative Governance on Superannuation Boards, June 2014

“A potential downside of ... less tailoring of life insurance policies and investment strategies to specific demographics of fund members; for example, if members work in the same industry. Some superannuation funds have been able to tailor insurance and other product features because of the homogeneous nature of their membership.”⁵

Cbus, as the industry fund for construction and building employees and employers, concurs with this observation and argues that industry affinity, in no short measure arising from the equal representation model of governance, has resulted in tailored services, products and investments that reflect the needs and interests of industry participants.

The industrial relations system, its instruments and bodies, should maintain the central role in default selection to oversee quality filtering of default funds as well as maintaining the benefit of industry understanding and tailoring.

Given the nexus between super contributions and wages and conditions, Cbus believes that the Fair Work Commission is ideally placed to perform the role of selecting default funds. It is a quasi-judicial body accustomed to applying the rules of natural justice, and making its decisions having regards to the substantial merits of the matter before it. Its processes are open, low cost and all the evidence before it is in the public domain. Its reasons for decisions are made public and its decisions are subject to judicial review.

Further, the quality-filter adopted in S156F of the Fair Work Act is sufficiently robust, appropriate and meets the substantive issues raised in the FSI Report and the Productivity Commission’s findings on default selection.

All MySuper accredited funds may apply to be named as a default fund in a Modern Award under the Fair Work Commission process, they are then subject to being filtered to a short list based on a clear criteria.

The two-stage process described in the Act allows for both a national selection and an industry suitability application, thus it overcomes the potential downside of less tailoring as described above, while effecting competition overlaid with a quality-filter in the default fund system.

While it is true that not all employers and employees are bound by the relevant industry Modern Award, it is also true that Awards act as integral reference points for employment conditions across industries, well beyond the scope and parties bound by the Award.

It is our submission that the selection process of default funds in Modern Awards by the Fair Work Commission should be maintained and allowed to proceed. The outcome of this process will provide a quality reference for employers and employees alike both inside and outside of the enterprise bargaining system.

⁵ FSI Final Report, Chapter 2, Superannuation and retirement incomes.

Cbus recommends that the Report's recommendation be set aside given that a 'formal, competitive process' already exists within the current industrial relations system; that a quality-filter system already exists; that industry funds as defaults continue to outperform other MySuper funds and that efficiencies from the Stronger Super reform have yet to be fully realised. Further that the Government should recommence the Fair Work Expert Panel process of accessing default funds in Modern Awards immediately.

FSI Recommendation 11

Require superannuation trustees to pre-select a comprehensive income product for members' retirement. The product would commence on the member's instruction, or the member may choose to take their benefits in another way. Impediments to product development should be removed.

Cbus lends qualified support to the recommendation.

Cbus has been giving some consideration to default and automatic transition to retirement income accounts.

We particularly commend the work and recommendations of the working group convened for the Inquiry by the Actuaries Institute.

Cbus agrees the need for there to be clear opt-out provisions and protections for members in the establishment of default retirement products.

Many Cbus members, having worked in physically demanding jobs throughout their lives, find themselves looking at forced retirement due to physical deterioration and age discrimination associated with working in an industry that preferences a younger, more physically capable workforce.

The transitory and precarious nature of work across the construction and building industry can mean that consistency in superannuation contributions may be disrupted for significant periods of time across the working life.

And the overrepresentation of the construction and building industry in the non-payment of the superannuation guarantee⁶, can combine to leave members with low balances at preservation age or before.

Members with low to modest balances must maintain a right to withdraw their entire accumulated balance from the system once they have retired or met a condition of release.

There is far more need for many members to retire debt or make other adjustments to retirement than staying in the super system.

⁶ Tria Investment Partners, Superannuation Guarantee non-compliance, September 2014

There is no advantage for members with low balances keeping their super savings in the system post retirement. Even the current zero tax rate applicable to over 60s with all forms of super income streams is easily matched with the current level of tax free threshold at \$18,200.

Additionally there is no advantage with any Centrelink benefits as super income streams are considered on the same deeming rules as ordinary money investments.

We welcome the Reports recognition of this position and submit that the Government too recognise the importance of this flexibility should it be drawn to the Report's recommendation.

It will be important in ensuring that retirement income solutions are tailored to the best interests of members, making a comprehensive income product for retirement that can offer a range of solutions a far more attractive option than a mandated one-size-fits-all approach.

Cbus welcomes the Report's findings that:

"People have different needs in retirement and will value the three desired attributes of retirement products (income, risk management and flexibility) differently. CIPRs should deliver a balance of these attributes. As no single product has all these features, a CIPR is likely to be a combination of products."⁷

Trustees must be able to offer a range of solutions to different groups of members that it identifies. The solution should be able to be made up of several products and investment options as identified as necessary by the trustee's assessment.

It is likely that industry funds, with their affinity and understanding of the industry that they cover, through their equal representation model of governance and workplace distribution models through the default fund system, will be much better placed to tailor default comprehensive retirement income solutions that work well for larger cohorts of members. Nevertheless, flexibility to tailor solutions and opt-out provisions must be a part of the solution.

It is also admirable that the FSI Report acknowledges that behavioural factors, such as 'behavioural nudging' to influence member choices, will require regulator oversight to ensure providers are not 'gaming' the system or detracting from the purpose.

We concur with the recommendation to remove impediments to product development while maintaining the necessary safeguards to meet the overarching objective of the superannuation system.

⁷ FSI Final Report, Chapter 2, Superannuation and retirement incomes.

However, we do not believe that an additional licensing process over and above the MySuper regime already in place is required. Rather, there should be necessary amendments to the existing MySuper Regime to allow MySuper providers to expand their services to retirement income products and solutions.

A necessary part of the expanded regime would be the annual attestation requirement for a comprehensive solution that would ensure the trustee is considering, at least annually, that it is still offering the right solutions to retiring members.

In order for members to be able to understand the trustee's choices there should be a standard mechanism for providing an estimated level of income; probability of how long it is likely to last in retirement; and the level at which key retirement risks are addressed (e.g. sequencing of returns, longevity – outliving savings, liquidity and lack of diversification).

Beyond that, Cbus submits that there needs to be a principles driven approach to approval of retirement income solutions.

Currently, prescriptive rules bind product developments disallowing more flexible and early placement of retirement income to address such risks as longevity and sequencing.

Cbus would prefer to see an authorisation process where each solution is assessed as being in compliance against a set of known principles by a body such as the ATO or APRA.

In that way members can enter into an arrangement such as a deferred annuity early and not be subject to punitive tax rates that reduce the benefits of the product.

Given the longer nature of these investments designed to address longevity, there should be some industry consideration given to their portability. Ideally members should not be locked into a product prior to drawdown phase without being able to transfer it to a new provider on a same principles basis.

A methodology for ensuring the new principles based approach is not misused is that any investment placed into such a product is subject to taxation at the equivalent level it would have been if the member had kept the investment in the withdrawal phase if it is withdrawn early (e.g. death, disablement, financial hardship, etc.)

FSI Recommendation 12

Provide all employees with the ability to choose the fund into which their Superannuation Guarantee contributions are paid.

Cbus lends qualified support to the recommendation.

The Inquiry overlooks the established ground of behavioural economics and the success the default fund system has delivered with most nominated default funds outperforming the OECD average.

This recommendation further implies that ‘choice’ is somehow not being exercised through the democratic processes of making an enterprise agreement.

In enterprise bargaining, employees participate in the process of agreeing a log of claims, directly or indirectly guide negotiation positions and ultimately, vote to accept or reject the proposed agreement.

Through this process there can be little doubt that choice has been effectively exercised.

Default fund/s, called up from the Modern Award, can and should be nominated in enterprise agreements if that is agreed between the employees and their employer.

That said, Cbus agrees that everyone should be able to choose the fund their SG contributions are paid to.

The broader question of the types of protections that would be in place for consumers exercising choice remains.

While the FoFA reforms have laid a best interest duty over personal advice about superannuation, it may be that further protections are required to ensure those exercising choice and leaving default funds are no worse off.

FSI Recommendation 13

Mandate a majority of independent directors on the board of corporate trustees of public offer superannuation funds, including an independent chair; align the director penalty regime with managed investment schemes; and strengthen the conflict of interests requirements

13.1 Mandate a majority of independent directors on the board of corporate trustees of public offer superannuation funds

Cbus does not support this component of the recommendation.

Cbus supports sensible regulation to strengthen the governance of superannuation funds, where there is evidence that the regulation will be in the best interests of fund members and where such regulation meets the overarching objective of superannuation.

Consistent with our member-only focus, we support efforts to ensure that directors are free from influence from outside bodies when performing their fund role. We also support efforts to encourage critical-thinking in our superannuation fund boardrooms.

That said it is unusual for a government to interfere in the affairs of a corporation and to limit shareholders’ rights without a compelling overriding public interest.

Cbus does not believe that the overriding public interest has been identified.

The FSI Report itself notes that:

“Although there is little empirical evidence about the relationship between quality of governance in Australian superannuation funds and their performance....”⁸

Cbus does not accept the view that director independence is a panacea for improved fund performance, particularly where there is no consensus about the meaning of independence.

We reject the suggestion that directors who have a relationship with the fund’s shareholders or its nominating bodies are more or less incapable of bringing independent thought to the boardroom.

Not only has this recommendation been made with little reference to evidence, it has ignored that body of evidence that suggests that the appointment of a significant number of independent directors on funds may be counterproductive.

Elevating so called independence (or non-affiliation) above industry-knowledge, the ability to devote time to the task and a capacity for critical thinking is not right.

We would also point out that there has been a myriad of recent changes to fund governance with the introduction of Prudential Standards and guidance for Superannuation Funds and increased regulatory powers.

The FSI made no attempt to evaluate the efficacy of the APRA’s new prudential standards.

There needs to be time allowed for these changes to be fully integrated into funds and for the regulator to complete its round of prudential consultations and reviews before making any further changes.

The discussion in support of the recommendation in the FSI Report lacks substance and it is noted that the issue of independent directors was not aired or debated as part of the interim report consultation process.

Advocates for change have failed to identify a compelling argument that would warrant the government restricting the class of persons available to shareholders to appoint to the boards of the trustee.

Much has been made of the fact that independent director obligations apply to corporate Australia. This ignores the fundamental difference between the obligations of a trustee to beneficiaries.

It also ignores the fact that the ASX Listing rules were a response to a rash of spectacular corporate failures that were blamed in large part on the lack of oversight by Boards that were dominated by executive directors and where CEOs routinely acted as the Chairman of the Board.

⁸ Ibid

This is not the situation amongst APRA regulated funds.

In 2012 the Productivity Commission reviewed all of the arguments that have been advanced in favour of requiring a minimum number of independent directors on fund boards.⁹

The Commission did note that there are potential benefits from independent directors “where appropriate”¹⁰, it ultimately supported the APRA approach of not mandating any particular structure for superannuation fund boards.

In reaching this conclusion the Productivity Commission systematically reviewed each of the arguments advanced by the advocates of change. These included: the need for directors with particular expertise; the need for directors who can approach their role without fear or favour; and the need for a workable mechanism to remove underperforming directors.

Having reviewed the evidence the Productivity Commission concluded that there was no compelling evidence to support one model of governance over another.

It said:

The Commission considers that issues relating to board structure are important. However, overall, there is a lack of compelling evidence to suggest that any one model of board structure should be viewed as clearly preferable in all cases. Therefore, the Commission does not consider it appropriate at this time for a particular structure to be mandated. Further, the Commission would not want to see restrictions placed on board structures without such restrictions having a sufficient evidentiary basis....¹¹

The FSI Report failed to acknowledge a growing body of literature suggesting that the introduction of independent directors into corporate boardrooms has failed to improve critical thinking and effective governance and has been detrimental to firm performance.

A recent study¹² of almost 1000 firms found that those firms that introduced majority independent directors in response to the 2003 ASX listing Rules have experienced large falls in company performance and a loss of shareholder value compared with other firms.¹³

The authors estimate the losses over the period 2003-2011 conservatively at A\$69 billion.

⁹ Productivity Commission 2012, Default Superannuation Funds in Modern Awards, Report No. 60, Final Inquiry Report, Canberra.

¹⁰ Ibid at page 88.

¹¹ Page 104.

¹² Fischer, Marc-Oliver and Swan, Peter L., Does Board Independence Improve Firm Performance? Outcome of a Quasi-Natural Experiment (November 18, 2013). 26th Australasian Finance and Banking Conference 2013. Available at SSRN: <http://ssrn.com/abstract=2312325> or <http://dx.doi.org/10.2139/ssrn.2312325>

¹³ The study found majority board independence reduces firm performance regardless of whether the criterion is shareholder value in terms of the Tobin's Q or Market-to-Book ratios, or accounting performance as measured by the industry-adjusted ROA

The study also found that Boards dominated by independent directors were less likely to replace an under-performing CEO, paid poorly-performing CEOs significantly more than other Boards and paid significantly higher director fees.

The authors conclude that the introduction of majority independent directors has destroyed considerable shareholder wealth “with no discernible benefit other than to executives and fellow board members”.¹⁴

The FSI report claims that “...there is no evidence to suggest that the performance of these [representative governance model] funds is driven by their equal representation model.”¹⁵

This overlooks the findings of the McKell Institute that “...the available evidence does show a clear causal relationship between not-for-profit representative governance funds and higher levels of returns for members.”¹⁶

The McKell Institute report goes on to conclude that:

“..in spite of some shortcomings, representation is actually the model that most closely satisfies the objectives of meeting the best interests of members and maximising retirement incomes for Australians. The evidence for this claim is strong – the not-for-profit representative trustee model has outperformed its for-profit appointed trustee competitors on virtually every important criteria of superannuation performance over a long period. Although there may be scope for further improvement of the representative model, it promoted higher levels of diversity amongst trustees, more effectively minimises conflicts of interest, and, importantly, has continually outperformed the for-profit model over more than the past two decades, generating substantially higher net returns for fund members.”¹⁷

There is also a body of literature that examines the impact of independent directors within the boardroom. This literature questions the assumption that so-called “independent” directors produce more critical thinking and informed discussion, leading to higher quality decision- making.¹⁸

This, it is argued, is because regulators have applied a structural solution to a behavioural problem, focusing on the relationship of the director to the firm, rather than the capacity of the director to influence change, to resist inappropriate external influences and so forth.

This formal or structural independence – which focuses of the director’s relationship with the firm – does not take account of the complexities of the boardroom.

Three arguments are made:

¹⁴ Ibid

¹⁵ FSI Report, Governance of Superannuation Funds

¹⁶ The McKell Institute, The Success of Representative Governance on Superannuation Boards, June 2014

¹⁷ Ibid pg. 51

¹⁸ Wheeler, Sally, Independent directors and corporate governance, (2012) 27 Australian Journal of Corporate Law 168, see also Suzanne Le Mire and George Gilligan, (2012) Developing a More Complete Understanding of the Independence of Corporate Directors Working paper Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2180671.

(a) First, structural independence does not ensure diversity of cognitive ability. Boards tend to appoint people with similar training and experience to themselves, and strong social ties between directors that reduce the independent directors' capacity to be effective;

(b) Second, group dynamics will either mean that the outsiders disturb and compromise the environment of trust and shared values necessary for robust debate and questioning, or the outsiders quickly adopt the norms of the group and lose their capacity for independence¹⁹; and

(c) Third, those independent directors who are unfamiliar with the firm are susceptible to co-option by the CEO and executives and quickly lose their capacity for independence of mind.

What these findings tell us is that the quest for independence will not be met by simply ruling directors in or out based on their relationship with the fund, its shareholders or its sponsors, and that a much more sophisticated understanding of independence is required.

Cbus submits that mandating a majority of independent directors for all APRA regulated public offer superannuation funds would be an unwarranted and unsophisticated response to an unproven problem.

If the objective of the recommendation is truly to ensure that suitable levels of expertise, critical thinking, independent thought and time allocated to role are evident on trustee boards, then shareholders should be further empowered to make such an assessment and appointments as required.

Cbus recommends that the Government:

- Agree with the industry a broad and sophisticated definition of director independence.
- Positively oblige boards, as part of their annual review, to consider whether they have sufficient expertise, critical thinking, independent thought and can allocate the required time to the role; and/or whether members' best interests would be served

¹⁹ On the one hand psychologists who are expert in small group dynamics suggest that the optimal environment in which individuals feel able to raise different opinions, debate policies and question facts is one of trust and shared values. Given this, "outsiders" will not be effective, and may be counter-productive. As Sally Wheeler says *Indeed structural rules that force together individuals with disparate values and beliefs can be counter-productive. Those disparate values and beliefs introduce unproductive friction that gets in the way of the trust required to permit the sorts of robust analysis and debate that underpin constructive decision-making processes.*⁷ On the other hand, group dynamics suggest any outsider will quickly move to become an insider. *... group-think kicks in as new members of the board seek to address their lack of social capital in this new environment by 'building bridges' with the processes and personalities already present in the board. Only thereby do they gain the social efficacy to justify their presence at the board table. So within a few meetings the new members have assumed the social identity of the board they have joined and are as likely to be as over-confident about their joint capabilities, and as blind to their failures, as the directors of longer tenure.*

through the appointment of an independent chair and/or independent directors. Such considerations and outcomes to be reported to APRA.

- Remove from the SIS Act any restrictions on the ability to appoint independent directors and remove any restrictions on a trustee director being a member of the fund they oversee.

13.2 Mandate an Independent Chair

Cbus does not support the mandatory component of the recommendation.

There is no compelling reason to further limit the class of people who can be appointed to the Chair of a superannuation fund board.

The rationale for the ASX Principles was to split the roles of CEO and Chair to reduce the power of the executive and enhancing the power of the non-executive board members.

If this is the harm government wishes to guard against, it can be accommodated with a specific prohibition on the appointment of executive Chairs.

The Chair's role is to maintain a constructively critical environment, to encourage the informed contribution of the directors and promote effective communication between the executive and the Board.

The Chair should be responsible for ensuring that the directors receive accurate and timely information.

These skills can be found in "affiliated" directors.

The APRA prudential guidance to funds²⁰ states that a prudent trustee would consider whether the appointment of a non-affiliated Chair is appropriate.

Funds should be asked during their prudential review to advise APRA of the outcome of this consideration, and explain the reasoning of the Board and the shareholders similar to the 'if not, why not' features found elsewhere.

Cbus submits the recommendations as outlined in 13.1.

13.3 Align the director penalty regime with managed investment schemes; and strengthen the conflict of interest requirements.

Cbus does not oppose this component of the recommendation.

²⁰ APRA SPG 510

Cbus complies with APRA Governance Standards and guidance in respect to ‘fit and proper’ testing of directors and in managing conflicts and aims for the highest possible standards Governance standards amongst its directors, executive and employees.

Cbus notes again that the APRA standards strengthening conflict management were only introduced less than 2 years ago and would be interested to see what further strengthening the Report is recommending as necessary.

FSI Recommendation 21

Introduce a targeted and principles-based product design and distribution obligation.

Cbus supports the recommendation.

We note that improving disclosure and conflicted practices as a laudable objective and potentially bringing ‘best interest’ obligations closer to product providers as well as issuers is welcome.

FSI Recommendation 22

Introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment. Amendments to marketing, warnings, distribution restrictions and product banning

Cbus supports the recommendation

FSI Recommendation 23

Remove regulatory impediments to innovative product disclosure and communication with consumers, and improve the way risk and fees are communicated to consumers.

Cbus supports the recommendation

FSI Recommendation 24

Better align the interests of financial firms with those of consumers by raising industry standards, enhancing the power to ban individuals from management and ensuring remuneration structures in life insurance and stockbroking do not affect the quality of financial advice.

Cbus supports the recommendation but submits that the Government should move to ban commissions from all areas of financial services including life insurance.

Conflicted remuneration, such as commissions and sales volume based performance pay and bonuses work to the detriment of the system as a whole and often work against aligning the interests of consumers and service providers.

FSI Recommendation 25

Raise the competency of financial advice providers and introduce an enhanced register of advisers.

Cbus supports the recommendation, especially for those providing personal advice on tier 1 products.

It is Cbus' policy that fund members only be referred to a Certified Financial Planner (CFP[®]) for full personal financial advice as part of the Cbus and FPA Professional Practice Referral Program.

FSI Recommendation 37

Publish retirement income projections on member statements from defined contribution superannuation schemes using Australian Securities and Investments Commission (ASIC) regulatory guidance.

Facilitate access to consolidated superannuation information from the Australian Taxation Office to use with ASIC's and superannuation funds' retirement income projection calculators.

Cbus supports the recommendation.

Cbus first trialed the publication of Retirement Income Estimates (RIE) to small cohort of members, along with their balance statements, in the financial year 12/13 in accordance with ASIC's Regulatory Guidance 229.

The positive feedback received from members determined the Fund to send RIEs to a much larger group of members in FY 13/14. A little under 360,000 members of the Fund were sent a personal RIE along with their annual benefit statement between 22 September and 17 October 2014.

Research undertaken to track members' response to the RIE provision in 2014 found that:

- The RIE is well read by many members and the information is well received;
- Members who receive the RIE show a stronger relationship with the Fund and have a better opinion of the Fund compared to those who did not receive it;
- Receiving the RIE appears to improve members' perceptions of the super system as a whole;
- The RIE has had very strong results in driving (claimed) behaviour change among members who receive it.

The overall takeout from the research is that the provision of RIEs to members has a positive engagement impact.

However, it was observed that the RG229 framework has some less than desirable restrictions including:

- A lack of 'flexibility' on retirement age and inability to model different scenarios (ie. retiring earlier, making more contributions etc)
- Members struggled with concepts of 'in today's dollars' and 'inflation adjusted'
- Members would prefer to receive the RIE separately from benefit statements as it gets 'lost' amongst the various other information.

While accepting the need for standards that ensure against unrealistic claims being made by competing funds, Cbus submits that the Government and ASIC may wish to consider how to provide the following flexibilities to the regulatory guidance:

- Allow for RIE statements to be sent outside the annual benefit statement process.
- Allow for flexibility in mandatory text around impact of inflation to provide plain English explanations to members.
- Consider 'flexibilities' in estimate calculations to allow for actual investment choice and fund risk and return profiles.
- Allow for 'smoothing' of contributions over a 24-36 month period to allow for estimates to be provided to members who have made large one-off contributions in a particular year.
- Allow funds to provide 1 alternative scenario projection based on an assumption of a modest increase in contribution levels above the SG.

Cbus concurs with the need to ensure that funds are providing the most relevant and up to date information to their members to enable a better understanding of the potential retirement income outcomes.

By enacting the Report's recommendation to facilitate access to consolidated superannuation information from the ATO, superannuation funds will be much better positioned to provide a more holistic view to be presented to members.

Cbus submits that further improvement could be made, in addition to the core recommendation, by:

- allowing funds to make reasonable basis general advice recommendations based on these projections (e.g. consolidate your super to save fees, contribute more to improve your potential income, take more adjust you investment mix to improve your potential income or reduce risk)

- under similar relief, allow funds to provide tailored income estimates for those in the drawdown phase to provide them with information about how long their income may last based on recent returns and reasonable expectations of future returns. A number of general advice strategies could then be made to improve the outcomes for the member. This could include changing investment mix, drawing down more or less or potentially to seek advice.

As more Australians move into retirement, funds will not have the advice infrastructure to manage members accounts on a mass basis therefore methodologies which allow the trustee to assist members to manage their own outcomes in a cost effective way will be beneficial for all.

FSI Recommendation 40

Rename 'general advice' and require advisers and mortgage brokers to disclose ownership structures

Cbus provides qualified support the recommendation.

Cbus does not support the requirement to rename all 'general advice'. Rather, we would submit that sales activities that attract conflicted remuneration are called out for what they are.

A better alternative would be for the Government to expand the FoFA legislation to capture all financial services, including mortgage broking, insurance and tier 2 banking products and ban remuneration systems that are based on rewarding sales volumes or commissions.

Cbus does support the requirement to disclose ownership structures to better inform consumers about why they may be receiving certain product recommendations.