Submission to The Retirement Incomes Review

3 February 2010

Mr Michael Callaghan AM, PSM

Chairman Retirement Incomes Review

Attention: The Secretariat Retirement Income Review

The Treasury

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1. Introduction

This submission is related to the second "pillar" outlined in the terms of reference for the review, namely: "compulsory superannuation" and most specifically the role that "pillar" plays in "supporting Australians in retirement".

I have become most concerned regarding the uncertainty of how regulated superannuation funds, and in particular the Industry Funds, interpret, the covenants set out in Section 52 of the Superannuation Industry (Supervision) Act 1993 (SISA).

This concern has become fortified as the superannuation sector approaches having $3 trillion funds under management and hence many specialist interest groups and sectors of society may be encouraged to seek favourable outcomes for their interests through court and other public and private pressure on super fund trustee investment decisions.

Further the advent of various crowd funding entities means that some of those specialist interest groups potentially have access to sufficient funds to effectively indemnify them from the contingent liabilities normally associated with undertaking significant court actions.

2. Section 52 SISA Covenants

Essentially for the purposes of my submission the relevant parts of Section 52 are:

(2) The covenants referred to….include the following covenants by each trustee of the entity…..

(b) to exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as a prudent superannuation trustee would exercise in relation to an entity of which it is trustee and on behalf of the beneficiaries of which it makes investments;

(c) to perform the trustees duties and exercise the trustee powers in the best interests of the beneficiaries…….

(e) to act fairly in dealing with classes of beneficiaries within the entity;

(f) to act fairly in dealing with beneficiaries within a class……

(j) to allow a beneficiary of the entity access to any prescribed information or any prescribed documents.

Taken together these covenants may be taken to mean:

"*to perform the trustee's duties and exercise the trustee's powers in the best interests of the beneficiaries*" (Justice Mark Moshinsky Federal Court of Australia 9 March 2018 www.fedcourt.gov.au › assets › rtf_file › Moshinsky-J-20180309 - The continuing evolution of the best interests duty)

Justice Mark Moshinsky went on to outline the inherent uncertainty of what the above 'guiding principle' might mean in practice and law.

More recently and in the light of an impending Federal Court case (McVeigh V REST) the Law Society Journal raises similar uncertainties relating to the above covenants (December 2019 https://lsj.com.au/articles/risky-business-super-case-heats-up-climate-debate/)

2.a Can Super Funds Meet the Section 52 Covenants for both Retirement and Accumulation Members

I have not researched the situation for large Retail superannuation funds, but I have for Australian Super, the largest single superannuation fund in Australia with 2.3 million Members.

I have both a Retirement account and an Accumulation account with Australian Super.

Following a series of written questions to this entity in February / March 2019, seeking the composition of the investments for specific investment options (there are 11 offered by Australian Super) I was advised that most of these options involved separate Retirement and Accumulation pools, but that the composition of actual investments in these separate Retirement and Accumulation pools was essentially the same.

Indeed the following table (on the next page) was provided for the "**Stable**" investment option for the separate Retirement and Accumulation pools:

[*]Asset class	Accumulation	Retirement
Australian shares	9.2	9.2
International shares	12.5	12.4
Private equity	0.0	0.0
Direct property	6.3	6.3
Infrastructure	9.7	9.6
Fixed interest	31.8	31.7
Credit	3.0	3.0
Cash	27.6	27.8
Total	**100.0**	**100.0**

[*]*Australian Super 22 March 2019*

I was advised that the same applied across the other major investment options (eg High Growth; Balanced; Conservative Balanced; Property; Socially Aware; etc.).

However in my view it is quite impossible for any fund with a small percentage of Retirement / Pension members (hence large proportion of Accumulation members) to meet the essential trustee legal requirement to act: "*in the best interests of (all) the beneficiaries* (nee Members)" while utilising the same investment mix for the two cohorts**.** Because the best interests of those at the beginning of the Accumulation phase and those in the Retirement phase are diametrically opposed.

One cohort has essentially short and, at most, medium term interests and the other essentially long term interests.

Industry Funds, such as Australian Super, generally have been reported to have in the order of about 4% of active Retirement phase Members (most Industry Super Funds are only about 20 odd years old so relatively few active Members, as a proportion of the total, have reached retirement and many Members when they retire take the lump sum and hence cease to be active) and 96% Accumulation phase members.

Accordingly the most obvious way to overcome the fundamental conflict between the "best interests" of Accumulation and Retirement fund members – that is to establish different investment pools with different investment mixes for Retirement and Accumulation

Members – can be stillborn because there is a complete lack of scale for any separate and differently comprised Retirement pool.

And be wary of Industry Super Australia (ISA – the peak group association) telling you that the big Industry Funds already have separate Retirement and Accumulation investment pools – because in reality while Australian Super does…the pools comprise almost an identical mix of investments (see previous table).

They are separate only for ease of practical disparate daily crediting regimes (EG Retirement Members pay no tax on pool earnings whereas Accumulation Members pay 15% income and different capital gains taxes etc.). Further Retirement Members generally get the notional benefit of franking credit rebates (within the Retirement Member daily crediting rates) even though the Fund as a whole, when putting in its single Income Tax return pays enough tax on behalf of Accumulation fund Members to completely offset any such rebates.

To the best of my knowledge (that is to the extent I can get information from Australian Super) – as a Member of the biggest super fund, Australian Super, with about $170 billion under management and 2.3 million Members – the Trustees are, in my view, not very far down the road (perhaps not yet even embarked) of reconciling the fundamental conflict concerning acting in the best interests of both Accumulation and Retirement fund Members at the same time with essentially the same mix of investments operating in both Accumulation and Retirement account investment option pools.

2b. Further Inherent Difficulties for Funds Acting in the Interests of All Members as Equally as Possible

Superimposed on the inherent 'conflict' between the by definition shorter and medium term interests of Retirement account holders and the long term interests of Accumulation account holders, there is in my view the clear and present extra danger of imminent Court actions being undertaken by vested interest groups, such as the McVeigh V REST imminent Federal Court case being funded by Friends of the Earth according to the 27 January 7.30 Report on ABC TV 1 (https://www.abc.net.au/7.30/court-battle-over-climate-change-could-shake-the/11904416)).

A 24 year old gardener working for the Brisbane City Council is the applicant for a wide-ranging test case in the Federal Court concerning Australian retail and Industry super funds' investments and advice to members concerning Climate Change**.**

His case is against the Industry Super Fund REST, which covers largely retail sector workers.

McVeigh, the gardener, started having money put into his REST account at 15 when he was a part time worker for Woolworths during school and then tertiary education periods.

Accordingly his investments in REST are likely to be small. It is likely his current super arrangements will be with the Qld local government super scheme, LGIAsuper fund - which provides annual contributions of 19% of earnings comprising up to 14% employer contribution upon an employee contributing 5% of earnings).

It would seem likely that, if successful, his case may result in the eventual aim of having super funds slowly but surely restrict investing in what McVeigh and his legal and funding backers see as climate change antagonistic companies and activities

His lawyer is, David Barnden.

According to an article Branden wrote in Investment Magazine on 7 January last year worked for Environmental Justice Australia (EJA) when McVeigh embarked on the case (presumably only moving to Equity Generation Lawyers – the firm now carrying the case– and taking McVeigh with him later during 2019).

The following words are included in EJA's mission statement on its web site:

Our mission

We use our legal expertise to be a powerful force for change, to empower communities to protect the environment, and to achieve a better legal system that delivers justice to……..the planet.

What we do

We use the law to protect nature, empower communities and safeguard the climate

We litigate, we advocate, we collaborate……environmental justice.

We use our legal expertise on behalf of…..climate and nature.

Why we do what we do

We hold companies, directors and investment funds to account when they pursue projects that damage the climate we all share.

The funder for the Federal Court case is Friends of the Earth according to The 7.30 Report Tracy Bowden item on 27 January.

Costs are unlikely to be small as the barrister running his case is Ron Merkel QC (former Federal Court Judge).

Super funds now hold $3 trillion of investments. Around 14 million Australians have super accounts. Generally Industry Super Funds have about 4% of members in Retirement phase and around 96% in Accumulation phase.

People like McVeigh, activist lawyer David Barnden and lobbyist funding groups like Friends of the Earth are likely to increasingly try to use super funds and their investment policies to achieve political, social and other aims.

If the impending Federal Court case restricts super trustees in some ways – especially in the climate change area (which may produce short term drops in returns while promising some far into the future gains) I ask the following three major questions:

a. How can super funds "*act in the best interests of* (disparate) *Members*" in the context of current or potential future climate change consequences – when some members are 24 like McVeigh and only just beginning on the "Accumulation" phase of their super experience (eg McVeigh has at least 36 years to go before he can access his nest egg) – while other members are in the "Pension" or "Retirement" phase (IE no more contributions just living off returns from the nest egg built up during the previous Accumulation phase); and

b. The "best interests" of the two cohorts are almost diametrically opposed. Retirement account Members relying on a super pension from a known and fixed (or diminishing) quantity of nest egg may regard their interests and returns involve their super funds utilising current high iron ore and coking and thermal coal prices (and hence potential short term dividends and capital growth). McVeigh is not likely to have real interest in short term yields or capital growth events ….he is in it for the long term and wants to avoid risks that potentially may be associated with stranded assets; and

c. Similarly (but not so severely as the almost diametrically opposed financial interests of "Retirement" and "Accumulation" super Members) the closer an Accumulation account Member gets to 60 or 65 so their financial best interests move from aligning with the 24 year old McVeighs of this world and closer to existing Retirement account Members!!

Cases being run by specialist interest and sectional interests groups can only further complicate super trustees' understanding of, and meeting the covenants outlined in Section 52 of SISA.

For both the reasons outlined in 2.a and in this 2.b, significantly more guidance needs to be provided to superannuation trustees than is currently contained in Section 52. Otherwise the courts are likely to produce some potentially harmful decisions in relation to particularly Retirement account Members.

2.c Crowd Funding Court Cases Makes Action More Urgent and Necessary

I refer to two recent examples, namely the crowd funding of the Israel Folau unlawful dismissal case and the defamation case Senator Hanson-Young initiated involving former Senator David Leyonhjelm (now subject to appeal).

It is arguable both initiators of the actions were inoculated against legal costs by versions of crowd funding (Australian Christian Lobby and GoFundMe respectively). Cases which might have otherwise been resolved more discreetly, cheaply and quickly ran on for months and took up the time of the Courts.

In McVeigh's case it appears it is Friends of the Earth that is doing the indemnifying. To the best of my knowledge it receives most of its funds from donations (that is crowd funding of another kind).

Such new crowd funding options intensify the likelihood of specialist interest and sectarian groups being able to take aim at the financial power of super funds and through court actions or public pressure achieve investment outcomes that suit their ideals.

3. Conclusion

I request the Review to consider the “best interests” ambiguity and uncertainty arising from:

- the current ambiguity and uncertainty revolving around Section 52 of SISA;
- the current conflict between the “best interests” of Accumulation super account Members and Retirement super account holders and how and whether the regulated Retail, Corporate and Industry funds are interpreting Section 52 in reconciling the two cohorts’ very different ‘best interests’; and
- the extent to which growing crowd funding mechanisms, effectively indemnifying applicants from significant contingent legal cost liabilities when mounting actions against super funds, makes review of the workings of Section 52 an urgent priority.

Ian McGarrity

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