

A SUPER CHALLENGE: KEEPING IT SIMPLE

A FUND'S BEST POLICEMAN IS ITS MEMBERS



By **BRIAN SCULLIN**

After years of changes and complications, it is time for another superannuation revolution — this time, in the direction of a simple, friendly system.

The superannuation system which Australia is developing is a unique form of retirement income policy by world standards, having a basis of compulsory saving located in the private sector. It has the potential to be the best combination of features in the world, integrating the efficiency which comes from competition with the benefit of appropriate prudential government guidance. However, superannuation will only achieve its full potential if these two ingredients are blended in the right balance.

A superannuation fund is usually a trust arrangement, which is suitable because it provides security for members' benefits (particularly by divorcing employers from the ownership of assets backing the benefits) yet makes those benefits subject to appropriate contingencies.

The trustees should be ordinary, honest and prudent people with common sense. Their fiduciary duty broadly is to look after and represent fund members and to balance their interests. They do not need to be professionals to do this. However, they may need to seek advice from experts and engage them to perform various services where appropriate.

In designing suitable extensions to the prudential framework in which trustees operate, a major aim ought to be to enhance trustees' capacity and willingness to represent mem-

bers properly, not to interfere with their decision-making. The requirements should not deter suitable persons from becoming trustees or impose undue costs on the funds.

The other aim of this approach should be to enhance members' capacity to safeguard their own savings. Superannuation savings remain personal savings and the basic philosophy of prudential control ought to be to enable and encourage active member interest and involvement.

Reporting standards

While we must be careful not to burden superannuation funds unnecessarily with expensive information requirements, or to overload members with material they cannot assimilate, it is clearly desirable that fund members know how their savings are being invested and why. Good funds are already providing their members with this sort of information and it is appropriate that the law establishes minimum standards to be met by all funds.

The industry and the government agree that the establishment of these standards is the first and most vital step in ensuring that superannuation savings are secure. The most effective "policeman" in ensuring that a fund's investments are prudently invested is a well informed

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and active membership. If members can effectively supervise the investment of their own savings, then there will be much less need for government intervention.

The Insurance and Superannuation Commission (ISC) is producing new member reporting standards which will take effect from 1 July 1992. Under these provisions, funds will have to provide members each year with information including:

- a statement of the trustees' investment objectives, strategy and policy, and amounts invested in different asset classes;
- a description of any single investment which accounts for more than 10 per cent of the fund's total investments;
- names and addresses of investment manager/advisers to the fund;
- a statement of the fund's policy on reserves; and
- actual and credited earnings rates of the fund.

Further, specific requirements apply when members enter or leave a fund.

These new reporting requirements will result in the need for funds to undertake a substantial education campaign. For example, where members' accounts are credited with an earning rate which is different from the earning rate of the fund, trustees will need to explain their approach to reserves and why they have declared a particular earning rate. The average members of a superannuation fund are not professional investors; it will be important to provide them with digestible and relevant information and educate them about the significance of that information.

Simplification

Members can use the information

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provided under better reporting standards only if they understand the system better. Therefore, the other challenge facing both the government and the superannuation industry is the pressing need for simplification of the current tax and regulatory regimes.

The government indicated in February 1990 that it would be considering superannuation in the context of tax simplification and there are rumours of a possible announcement of at least the broad thrust in the near future.

Areas that are ripe for substantial simplification include:

- **The reasonable benefit limits (RBL) system**, which places a maximum on the amount of tax concessional benefit available to each member. One approach is to replace the nexus to the member's salary with an indexed, relatively high dollar amount and to scrap the maximum contribution limit.
- **Lump sum benefit tax**. Some have suggested replacing the pre- and post-1983 grandfathering provisions with an intermediate but uniform rate which would ensure that only very few people were penalised.
- **Consolidation of preservation requirements** to replace the current hotch-potch of rules.
- **Tax concessions** for member contributions, perhaps replacing the

current complex four-stage system of deductions and rebates with a simple single-rate rebate system.

It is tempting for both government and industry to say that the best approach to simplifying the system would be to stop the process of change, giving everybody a chance to "catch their breath", to understand and digest the complexities of the system which now exists. Such a moratorium on substantial change is superficially attractive and is probably seen by the industry and regulators as a major objective if the public is not to give up totally on super as being "too hard" and if the industry is to cope.

However, it would be counter-productive if, for the sake of certainty and stability, the regulatory authorities were to set the system in concrete just at the point when it is at its most anomalous, complex and expensive to administer.

It is to avoid such a situation that ASFA supports the implementation of significant simplification of the regulatory regime as soon as possible. ASFA believes that any simplification must achieve the following:

- significantly better public perception and understanding of superannuation and how the system works;
- substantially reduced costs of administration for the benefit of both practitioners and members;
- an extended period of stability, with no further major changes for some years.

ASFA realises that no such simplification will be possible without trade-offs. There must be "give" on

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and taxes;

■ the start of a new performance reporting period.

When the return of a sector of a portfolio is required, extra events can trigger the requirement for portfolio and sector valuations and return valuations:

■ cashflows between sectors, eg, asset re-allocation or uninvested income;

■ changes in exposure because of the impact of derivatives.

Although these events may lead to frequent performance calculations, we do not suggest a short-term view of performance; in some circumstances, frequent calculations may be required to ensure accurate and meaningful long-term results.

Performance decomposition

Once the performance calculations are outlined for the total fund and the sectors of the fund, and the sector allocations are determined for each period between the relevant "events", an accurate performance attribution can be derived showing:

■ contribution from the pre-defined strategy as measured by a benchmark portfolio (benchmark return);

■ contribution from sector allocations which differ from the benchmark (asset allocation management return);

■ contribution from stock selection within each sector of the portfolio (stock selection return for each sec-

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tor and total portfolio).

The future

A number of areas are to be, or are being, addressed:

■ education of fund managers and consultants about the need to follow the guidelines to achieve accurate performance calculations;

■ implementation of the guidelines and extra data requirements;

■ data requirements for performance numbers required by regulatory bodies and the caveats necessary when these cannot be met.

A major practical issue is implementation of the required calculations. If a fund manager is currently obtaining only weekly or monthly valuations, it is likely that he will need extra data to ensure that valuations are triggered whenever certain events occur. This will place an additional load on both front and back office operations of fund managers.

The question of the accuracy of more frequent portfolio valuations may also be raised: how many fund

managers have problems with the accuracy of timely monthly valuations?

Further, systems to provide accurate performance calculations have yet to be fully developed for all but a handful of managers. Approximations will continue to be used for some time.

It may be that the performance surveyors will not need the detailed day-by-day performance data used by some managers to calculate accurate returns; fund managers should be able to provide accurate monthly calculations of total fund performance, sector performance and performance decomposition.

Following our performance calculations standard will mean that useful and accurate information will be available to assist fund sponsors in monitoring and reviewing fund managers' abilities as measured by performance, and fund managers will have a sound base from which to monitor their own strengths and weaknesses. ■

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both sides—a small number of members may be made marginally worse-off on the one hand and, on the other hand, there may be some future cost to government revenue.

Complexity is both inefficient (in terms of added costs to both funds and government) and inequitable. A simpler system of regulation is inherently a fairer system. At present the complexity favours those who are "in the know" or who have access to expert advice.

Those without this access can easily lose by taking decisions without a full appreciation of the implications.

There has been a worldwide trend towards greater regulation of the private pension/superannuation movement with the aim of producing outcomes perceived as:

■ *adequate* in terms of standard of living after retirement;

■ *fair* in terms of the distribution of

benefits receiving tax assistance;

■ *secure* in terms of confidence that the funds will be available when the member comes to retire.

The past 10 years have seen a massive increase in the regulation of Australia's superannuation funds, much of which can be viewed as attempting to achieve these three objectives. Much has been achieved, but there remain a number of challenges in producing a simpler and more secure system. ■