

# Regulation Impact Statement – Annual Members’ Meetings

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## Background

### *Australia's superannuation system*

Australia's superannuation system contains around \$2.3 trillion in assets. Around \$1.4 trillion of these assets are held by trustees on behalf of members of Australian Prudential Regulation Authority (APRA) regulated funds.

Currently there are approximately 28 million superannuation fund member accounts, with around 40 per cent of members holding multiple accounts.

Under the current regulatory framework, trustees of APRA-regulated funds are required to provide annual reports and periodic statements to members. Members are able to request information from trustees under section 1017C of the *Corporations Act 2001* to assist in understanding benefit entitlements. However, there is no statutory mechanism that gives fund members the right to engage directly with trustees, senior executives and other relevant office-holders of APRA-regulated superannuation funds and question them about the operation and performance of the fund. While member information sessions do exist, they are conducted on a voluntary basis and not all funds hold them<sup>1</sup>.

By contrast, shareholders of public companies can engage directly with directors and executives through compulsory annual general meetings (AGMs). Shareholders also have the capacity to vote on binding resolutions. The purpose of corporate AGMs is to hold directors to account for their decisions. Members of registered managed investment schemes do not have the capacity to vote on ordinary resolutions. However, they do have the capacity to hold member meetings to vote on special and extraordinary resolutions, including removal of the responsible entity and winding-up the scheme.

### *Regulation Impact Statement (RIS) status at each major decision point*

On 7 June 2017 the Treasury certified that the *Review into the governance, efficiency, structure and operation of Australia's superannuation system – final report* involved a process and analysis equivalent to an Early Assessment Regulation Impact Statement for the annual members' meetings (AMM) measure.

The Office of Best Practice Regulation (OBPR) agreed that a RIS would be prepared through consultation to accompany the legislation for introduction into Parliament. The first pass RIS process began on 21 August 2017.

## The Problem

Trustees of superannuation funds are required to act in the best interests of their members. However, there are currently weaknesses in the accountability framework governing trustees. In particular, members do not receive clear information about fund expenses in annual reports. In addition, members do not have statutory mechanisms for questioning trustees about a fund's overall performance.

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<sup>1</sup> Board Governance of Not for Profit Superannuation Funds (2017), page 32.

This problem was clearly identified in the 2010 Super System Review, which highlighted the need for improved trustee governance and accountability to members. It stated that trustees should 'demonstrate that they know what they are doing and that they are willing to be open and transparent in their decision-making and regarding the outcomes they achieve for members'.<sup>2</sup>

It is also widely acknowledged that there is a lack of engagement between members of APRA-regulated funds and their superannuation. This likely reflects a range of factors, including failure to exercise choice, lack of interest and complexity<sup>3</sup>. While an overall low level of member engagement may not necessarily be a problem in and of itself, those members who want to engage with their superannuation fund should be able to do so. The 2010 Cooper Review stated that 'the system should operate for members, not vice versa'<sup>4</sup>. The most recent ANZ Survey of Adult Financial Literacy in Australia found that around one-fifth of respondents could not reply to questions regarding the best indicator of fund performance, and a similar number could not name any factors they would consider in selecting a fund<sup>5</sup>.

The Cooper Review also stated that trustees 'often seem removed from members and do not always understand, or seek to understand, members' positions or concerns'.<sup>6</sup> It highlighted the importance of increased accountability through higher levels of engagement and effective communication between trustees and their members.<sup>7</sup>

Against this background, there are limited opportunities for superannuation fund members to hold trustees and responsible officers' to account for the fund's performance. The inability of members to formally engage with the trustees of their funds can result in negative consequences for them.

- If trustees do not have a good appreciation of member needs it will be more difficult for them to act in members' best interests. There is a greater risk they will design products that are not suitable for their members
- Members may not be making informed decisions about their superannuation.

While Australia's superannuation system is compulsory, most members are free to move between funds. However, the transaction costs associated with moving can be significant. As such, it may be better for members to seek to improve the operation of their current fund.

At present, some trustees take active steps to facilitate engagement with members, including through roadshows and member meetings. However, these practices are not uniform across the industry. It is also recognised that while peak bodies encourage trustees to actively engage with their members, funds do not always do so.

While it is difficult to establish an explicit link between the level of member engagement and fund performance, it is clear that performance may suffer in the absence of member oversight and accountability. For example, funds may incur higher or unnecessary expenses or may adopt investment or insurance strategies that are not suited to members.

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<sup>2</sup> *Super System Review Final Report (2010)*, Part Two: Recommendation Packages, page 56

<sup>3</sup> *Super System Review Final Report (2010)*, Part One: Overview and Recommendations, page 7

<sup>4</sup> *Ibid*, page 1

<sup>5</sup> [The 2014 ANZ financial literacy survey](#), p4.

<sup>6</sup> *Super System Review Final Report (2010)*, Part Two: Recommendation Packages, page 56

<sup>7</sup> *Ibid*.

While trustees are charged with acting in members' best interests, there is currently no statutory mechanism through which effective communication can occur between engaged members and their trustee. This has the potential to discourage engagement and erode confidence in the system as trustees are not held to account for their actions.

## **Why is Government action needed?**

Government action is required because the problem stems from an information asymmetry, which funds have been unable to resolve. High levels of disengagement mean that the capacity of fund members – the ultimate beneficiaries of superannuation – to request information from their funds, and to hold trustees accountable for their performance, is reduced. Industry, left to its own devices, has not developed a uniform mechanism for enabling members to hold trustees accountable.

The law does not prevent trustees of APRA-regulated funds from holding member meetings on a voluntary basis. However it does not require them to do so. Members of certain APRA-regulated funds will not have the opportunity to hold their trustee to account via an Annual Members' Meeting unless this requirement is made compulsory through regulation, which will require government action (in line with the statutory requirements that apply to directors of public companies and responsible entities of registered managed investment schemes).

## **Policy options**

Three policy options were considered to address the problem identified in this regulation impact statement (RIS) – that is, the accountability deficit arising from a lack of opportunity for members of certain APRA-regulated superannuation funds to question trustees, executives and other relevant office-holders on fund performance.

- **Option 1: Status quo**  
This option involves no change to the current law. Trustees could choose to engage with members if they wish, but it would not be compulsory to do so and the law would not contain rules on how this should be done.
- **Option 2: Flexible annual members' meetings (AMMs) without voting**  
This option involves a change of law to require trustees of certain APRA-regulated funds to hold annual member meetings and to allow regulations to be made prescribing information to be provided to members. However, trustees would retain flexibility over how AMMs are conducted including holding virtual meetings. Also, while members would be able to ask questions, and trustees would be required to answer them, there would be no formal voting on resolutions.
- **Option 3: Physical annual members' meeting with voting**  
This option differs from Option 2 in two respects. Firstly, trustees would be required to hold a physical members' meeting each year. Secondly, in addition to questioning trustees, executives and other relevant officeholders, members would be able to vote on non-binding resolutions.

## **Impact analysis**

This section discusses the costs and benefits (including compliance costs) of each option. The Office of Best Practice Regulation has agreed to the compliance cost estimates discussed in this section.

Community organisations will not be affected by the options.

Small businesses should not be affected by the changes as they will not apply to self-managed superannuation funds (SMSFs) or small APRA funds (SAFs). Each member of a SMSF must also be a trustee. While SAFs have separate trustees, they only have up to four members.

The impact on government will be minor. In the short-term, implementation costs will be incurred to draft the legislation for the proposed amendments. In the longer term it will be necessary for the regulator to monitor compliance with any new legal requirements.

### **Option 1 – Status quo**

This option would result in no additional costs or benefits for stakeholders. It would not impose any additional compliance burden on superannuation fund trustees.

Under this option, there would be no obligation on trustees to hold members' meetings to discuss the performance of the fund. These meetings would occur only on a voluntary basis. As such, many members would remain unable to question trustees on the performance of their fund. The current accountability gap would remain.

### **Option 2 - Flexible annual members' meeting without voting**

#### **Costs**

Option 2 would impose direct costs on superannuation funds in relation to:

- required attendees (which would include directors, auditors, actuaries and relevant senior executives). In this regard, executives would need to be at the AMM for the period of time to be questioned about the fund's operation and performance;
- notifying members of the AMM; and
- an information technology (IT) build to create a mechanism to conduct the AMM (i.e. online portal to facilitate delivery of podcasts and any distribution of relevant electronic statements).

This option would create some costs for fund members as they will ultimately bear the cost of holding AMMs. Compared with Option 1 (status quo), we estimate that Option 2 would involve an overall initial cost of \$8.5 million (mainly related to IT) and ongoing costs of around \$13.7 million per year. The annual compliance cost impact, averaged over 10 years, is estimated at \$14.6 million. These costs would be spread across 144 RSE licensees and 221 funds (around \$66,000 p.a. per fund). Page 11 provides more information on how these costs are calculated.

#### **Benefits**

By increasing the visibility of fund operations and the opportunities for members to involve themselves more actively with their funds, this option may improve incentives for members to engage directly with funds. By increasing accountability, it has the potential to improve fund performance, which will benefit all members, and strengthen confidence in the superannuation system as a whole.



Engaged fund members will benefit from the capacity to ask and have answered questions about the overall operation and performance of their funds. This will help to overcome the current accountability gap. For example, members will be able to ask questions about the rationale for particular investment strategies. Members will also be able to question trustees about fees and fund expenses.

The extent to which the benefits are realised will depend on the level of interest of fund members. It is therefore important to provide trustees with flexibility to hold AMMs in a way that best suits their membership base. This will have the best chance of maximising member engagement.

More broadly, more engaged members are more likely to improve the performance of the sector. They may exert downward pressure on fees and increase returns to members. Making trustees more accountable to members may also improve governance standards. The final report of the Fraser Superannuation Governance Review noted the potential value of AGM-style meetings as one way of improving transparency and accountability.<sup>8</sup>

Providing an avenue for members, and other stakeholders, to directly engage with the trustee and ask questions is an effective way for trustees and funds to identify and respond to issues that are of interest to their members and stakeholders.

Compared with Option 3, members and trustees will benefit from increased flexibility and lower ongoing compliance costs.

### **Net benefit**

Option 2 provides a formal opportunity for engaged members to question superannuation fund trustees, executives and other relevant officers, holding them to account at reasonably low cost. It also provides funds with the freedom to choose the most appropriate approach to AMMs.

The net benefit of Option 2 over the status quo will ultimately depend on the willingness of members to take advantage of the opportunity to participate in AMMs and the extent to which this results in better performance by trustees. Based on attendance rates for AGMs of ASX200 entities, it is likely that superannuation fund AMMs would attract up to 140,000 attendees.

Option 2 will provide a net benefit to members if the improvements in performance exceed the cost of holding AMMs, in other words, if it delivers annual improvements of more than \$66,000 per fund in funds' performance.

## **Option 3 – Physical annual members' meetings with voting**

### **Costs**

This option would impose similar costs as Option 2 above.

In addition, Option 3 would restrict the ability of funds' to utilise existing practices, where they might have flexible member engagement programs already in place.

Fundamentally though, the two key differences are that funds would be subject to the additional costs of holding physical meetings and facilitating voting. However, as trustees cannot be subject to

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<sup>8</sup> Bernie Fraser (16 February 2017) *Board Governance of Not for Profit Superannuation Funds*, page 32

direction under current superannuation law (reflecting the trust framework underpinning superannuation), voting would be on a non-binding basis.

As with Option 2, this option would impose costs on fund members as they will ultimately bear the cost of holding AMMs. The cost of Option 3 is expected to be higher than the cost of Option 2. Compared with Option 1 (status quo), we estimate that Option 3 would involve an overall initial cost of \$8.5 million and ongoing costs of around \$19.3 million per year. The annual compliance cost impact, averaged over 10 years, is estimated at \$20.1 million. This is materially larger than Option 2 (which was estimated at \$14.6 million per year). These costs would be spread across 144 RSE licensees and 221 funds (around \$91,000 p.a. per fund). Page 11 provides more information on how these costs are calculated.

### **Benefits**

The potential benefits of Option 3 are expected to be largely the same as Option 2.

Physical AMMs may provide more accountability to the extent that trustees are 'put on the spot'.

However, there do not appear to be any other additional benefits from requiring physical meetings (as opposed to allowing trustees to hold meetings in a flexible manner i.e. on-line). Also, it may be harder for members to participate in a physical meeting compared with a virtual meeting.

The capacity to vote on non-binding resolutions may be an additional benefit of Option 3 compared with Option 2 (under which members would just be able to ask questions).

Voting could provide an additional level of accountability for trustees. The outcomes from voting would send a clear message on how members view their actions or decisions. While this additional level of accountability is beneficial, the fact it would be non-binding lessens those benefits.

While the outcomes of voting would not be binding on trustees, trustees may take the outcomes of the voting into account when meeting their fiduciary obligation to act in their members' best interests. However, it is unclear whether votes of this type would have much 'weight' if participation is limited to a small proportion of members.

### **Net benefit**

Option 3 appears to offer many of the same potential benefits as Option 2 at a higher cost.

The net benefit of Option 3 over the status quo will ultimately depend on the willingness of members to take advantage of the opportunity to participate in AMMs and the extent to which this results in better performance by trustees. Based on attendance rates for AGMs of ASX200 entities, it is likely that superannuation fund AMMs would attract up to 140,000 attendees.

Option 3 will provide a net benefit to members if the improvements in performance exceed the cost of holding AMMs, in other words, if it delivers annual improvements of more than \$91,000 in the performance of a fund.

The key issue is the extent to which the potential benefits of allowing AMM participants to vote on non-binding resolutions justifies the additional cost and complexity of introducing non-binding voting.

We consider that non-binding voting is unlikely to increase member engagement compared with Option 2 and therefore that the additional expense to facilitate this would not be justified.

## Calculations

The table below shows the assumptions underpinning the estimated cost impact of each of the options, beyond the status quo.

<b>Annual Member Meetings (AMMs)</b>	<b>Flexible annual members' meetings without voting</b>	<b>Physical annual members' meetings with voting</b>
<b>Start-up costs</b>	\$8.5 million	\$8.5 million
<b>Average per year cost</b>	\$14.6 million	\$20.1 million
<b>Physical location</b>	Venue hire cost \$6,000 for 3 hours Assumes 5 assisting staff and the AMM going for 3 hours Assumes the key senior executives (CEO, CFO, CIO), actuaries and auditors are in attendance and the AMM going for 3 hours Assumes board size to be 7 and the AMM going for 3 hours	Venue hire cost \$12,000 for 3 hours Assumes 20 assisting staff and the AMM going for 3 hours Assumes the key senior executives (CEO, CFO, CIO), actuaries and auditors are in attendance and the AMM going for 3 hours Assumes board size to be 7 and the AMM going for 3 hours
<b>Web based location</b>	It is assumed 80 per cent of funds will seek to hold AMMs online Assumes 2 assisting staff and the AMM going for 3 hours Assumes the key senior executives are in attendance (CEO, CFO, CIO) and the AMM going for 3 hours Assumes board size to be 7 and the AMM going for 3 hrs	N/A
<b>Other costs associated with setting up the AMM</b>	Assumes ongoing team (3 staff) working on the delivery of an AMM for a period of 1 week leading up to and 1 week after the AMM  Security	Assumes ongoing team (3 staff) working on the delivery of an AMM for a period of 1 month leading up to and 1 month after the AMM  Additional costs related with printing of material to facilitate voting and cost of providing voting material at the AMM  Security

## Methodology

Data used in the determination of the cost impact of the proposed options was obtained from the public and private sectors, including through a direct public consultation process.

The following key assumptions were made:

- 144 RSE licensees (trustees) with 221 superannuation funds will be affected by the requirement to have an AMM. The requirement will not apply to trustees of SMSFs or SAFs.
- AMMs will be held per fund for trustees with one fund. 50 per cent of trustees with multiple funds will hold a single AMM while the remaining 50 per cent of trustees with multiple funds will choose to run independent AMMs for each of their respective funds.
- Given the low attendance by shareholders of ASX200 companies of 0.5 per cent and small ASX companies of 0.2 per cent, funds are unlikely to hold physical AMMs in large locations given the choice.
- For the flexible options, it is assumed that 80 per cent of funds would hold AMMs online.

- Notification of the AMM will be incorporated into current requirements or via Email.

In the development of the costing in this RIS, consultation was undertaken with key industry stakeholders.

## Consultation

On 24 July 2017, the Government released the draft Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017 (the draft legislation) for public consultation.

The legislation is part of a broader package of measures to improve accountability and member outcomes. The package also comprises changes to APRA's prudential framework.

All interested parties were invited to make a submission by 11 August 2017.

Treasury held roundtables in Sydney and Melbourne during the consultation period.

Stakeholders were broadly supportive of the AMM measure. However there were some doubts about the effectiveness of AMMs as an accountability device given high levels of member disengagement. Participants emphasised the need to maximise flexibility and minimise compliance costs associated with AMMs.

In particular, stakeholders were concerned that the requirement to notify members 21 days before the AMM would create additional compliance costs (i.e. notification by physical mail outs).

To address this concern, the Bill has been amended to align the time period for sending documents with existing Corporations Act periodic disclosure requirements. The explanatory memorandum to the Bill has also been amended to clarify that notification can be by electronic means as provided by the application of the *Electronic Transactions Act 1999*.

Stakeholders were also concerned that the draft law did not provide enough clarity on how AMMs will work in practice. This could result in some stakeholders 'over-engineering' their AMMs, adding to the cost of holding them. We are confident that the current Bill provides adequate flexibility. However, regulations can be made if necessary to provide certainty on particular issues that may arise in the future.

Specific comments on the AMM proposal are noted below.

The Australian Institute of Superannuation Trustees (AIST) recognized the value of direct member contact with superannuation fund boards and senior management.

"Providing a means for members to engage with the people managing their hard earned superannuation is a good way to identify those issues which are of most interest to members," Ms Scheerlinck said. (AIST, Media Release: 'Superannuation reform package requires careful analysis' 25 July 2017)

In its final submission on the draft legislation AIST stressed "that funds should be given the freedom to choose the most appropriate engagement strategy with their members, while ensuring that such engagement occurs." (AIST Submission, 'Improving Accountability and Member Outcomes in Superannuation', 11 August 2017)

In a similar vein, Cbus recommended that the legislation “avoid being overly prescriptive in terms of limiting trustee decision making regarding the most appropriate way to deliver member briefings.” (Cbus Submission, 11 August 2017)

Industry Super Australia (ISA) was similarly supportive in their response to the draft legislation.

“Industry Super has welcomed the adoption of the Fraser Review recommendation that funds hold annual member meetings.” (ISA, Media Release: ‘New consumer protections in super welcome but should go further’ 24 July 2017)

However, in its final submission on the draft legislation ISA did note that “specific implementation of this reform could be improved because the practical differences between the proposed superannuation Annual Member Meeting and Annual General Meeting (AGM) (pursuant to the Corporations Act) seem to be ignored.” (ISA Submission: ‘Superannuation Reform Package’, 11 August 2017)

The SMSF Association said that the “move to allow fund members to question the trustee board and executives of their superannuation fund annually will promote accountability and competition that should drive better outcomes for fund members.” (Media Release: “Government’s super reforms get thumbs up from SMSF Association”, 25 July 2017)

REST Industry Super stated that “careful thought needs to be given to any move to require that superannuation funds hold an annual member meeting.” (REST Industry Super, ‘Comments on draft Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017’, 11 August 2017)

The Association of Financial Advisers Limited (AFA) was broadly supportive of the Annual Members’ Meeting measure provided it “can be done in a cost effective manner and subject to sensible and pragmatic rules.” (AFA Submission, ‘Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017’, 11 August 2017).

We note that if the costs identified in submissions were to extend to apply to all superannuation funds then they would be significantly higher than the compliance costs identified in this RIS. This is largely due to the concern that the current processes for delivering information to members’ cannot be used to meet the new requirements.

Consultation indicated a strong industry preference for Option 2 over Option 3.

## **Conclusion**

Both Option 2 and Option 3 would allow superannuation fund members to formally question and engage with their superannuation funds, to hold trustees and responsible officers to account for their funds’ performance.

Option 2 provides clear benefits over the status quo. The costs of Option 2 are relatively small – \$14.6 million in compliance costs, compared to \$1.44 trillion in funds under management in the sector. However, given the vast size of the superannuation sector, even a small increase in competitive pressures through greater member engagement would have a significant overall benefit.

Option 3 also provides clear benefits over the status quo. It would also impose relatively small costs, which would be outweighed by even a minor rise in competitiveness. However, Option 3 does impose greater costs than Option 2, and is less flexible in its mechanisms for engaging members. This makes it unlikely that the greater costs would be offset by greater levels of engagement. The non-binding nature of voting under the *Superannuation Industry (Supervision) Act 1993* makes it unlikely that voting would offer additional benefits that would offset the associated cost.

Option 2 is therefore the best policy option for addressing the problem.

Ultimately, the question of Option 2 is better than the status quo will depend on the extent to which members participate in AMMs and the extent to which the introduction of AMMs strengthens trustee accountability and improves their financial performance for the benefit of all members, not just those who participate in AMMs.

## **Implementation and review**

The Government intends to implement Option 2 by introducing legislation into Parliament in the Spring Sittings with application of this measure from the 2017-18 income year and later income years.

Ongoing compliance and consideration of the benefits of AMMs will be monitored. Success will ultimately be marked by levels of member engagement. Measures include how many members participate in the meetings, whether the current disconnect between members and funds is reduced, whether superannuation products that more closely reflect the needs of members are developed, levels of trustee accountability in future meetings and engagement as measured by financial literacy surveys, such as the '*ANZ Survey Of Adult Financial Literacy in Australia*'.