

CORPORATE SUPERANNUATION ASSOCIATION

***SUBMISSION TO AUSTRALIAN PRUDENTIAL
REGULATION AUTHORITY***

ON

SUPERANNUATION CIRCULAR NO. II.D.1

MANAGING INVESTMENTS & INVESTMENT CHOICE

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1 BACKGROUND

1.1 The Corporate Super Association

The Corporate Superannuation Association is Australia's representative body for corporate superannuation funds and their corporate sponsors. The Association represents 35 large corporate funds.

1.2 Abbreviations used in this submission

The Association	The Corporate Superannuation Association
APRA	Australian Prudential Regulation Authority
The Circular	Circular No. II.D.1, "Managing Investments & Investment Choice"
Fund	Superannuation fund

1.3 Context of submission

APRA has invited comments on Superannuation Circular No. II.D.1, "Managing Investments & Investment Choice" issued in September 2005. This submission presents issues raised by members of the Association.

2 SUMMARY

The Association is supportive of the setting of investment guidelines for the management of superannuation fund investments.

In general, we are supportive of the proposals outlined in the circular, however, the proposals to:

1. impose a "whole of entity" requirement on the setting of investment strategies; and
2. impose a requirement on trustees to ensure adequate diversification at "member level"

require clarification.

In the case of the first, most funds operate on the basis of a global strategy which encompasses separate investment objectives and strategies for each investment option or, in the case of a defined benefit fund, each defined benefit section. The overall fund investment strategy is therefore the sum of the individual option strategies. In most situations this will not lead to any issues, however, in funds with very specific investment options, especially single asset options, this approach may lead to problems. We therefore support this recommendation, subject to the understanding that it is unlikely to be appropriate for a fund to have a single simple strategy. Instead, a composite strategy is likely to apply.

In the case of the second, few funds impose restrictions on member investment choice to ensure adequate diversification at member level. Provided the first recommendation (above) is adopted we see no reason for this second requirement. We refer you to 3.3 below for our reasons. The adoption of the first recommendation will automatically impose limits in the event that the fund is not adequately diversified or has specific liquidity requirements.

We note that there has been some concern that trustees may be responsible to individual members for potential lack of diversification at member level. We submit that this should not be a matter for trustees to address but rather propose practical steps to be taken by trustees as outlined at paragraph 3.3, to limit problems in this area.

3 ISSUES RAISED BY CORPORATE SUPERANNUATION FUNDS

3.1 General Comments

There are two matters in relation to member investment choice that emerge from the circular.

Firstly, the circular addresses the need to maintain an appropriate investment strategy at the “whole of entity” level. We suggest that this policy could be more clearly outlined in the initial pages of the circular. This will help put into context the recommendations contained in the circular. In addition, the reasons for this policy need to be set out clearly. In the absence of such reasons, confusion arises over whether investment choice is permitted, the context in which it is permitted and the degree to which it is permitted. In turn, this has led to many readers failing to understand the policy position proposed by the circular. Text along the following lines is suggested to clarify this situation.

“The underlying policy is that the provision of member investment choice does not remove the need for the trustee to ensure that the fund “as a whole” complies with the investment requirements set out under Section 52 (2) (f) of the SIS Act, and SIS Regulation 4.09. Provided a fund complies with these requirements then member investment choice is permitted. In some situations, it may be necessary to impose limits on member investment choices to ensure that the fund as a whole complies with the SIS Act and Regulations. Where member investment choice is provided it is expected that the trustee’s overall investment strategy will in turn set objectives and strategies for each option.”

The second source of confusion is the recommendation that there should be diversification at “member level” and that the trustee may need to impose restrictions on the member’s options to ensure this is achieved. As stated above we are opposed to this recommendation. If the recommendation is retained we suggest a review of the current wording to aid understanding.

3.2 Paragraph 33

The expression “relatively limited number” is open for interpretation. Some corporate and industry funds will have, perhaps, up to 10 or so options. A master trust may have 50 or more.

3.3 Paragraph 39

This paragraph imposes a requirement that trustees need to alert members to the need for diversification. It may be appropriate to more fully develop this theme as this key recommendation is not obvious. We disagree with the view that there is a need for the trustee to ensure the member diversifies and that, if necessary, the trustee should impose restrictions on member’s options.

In summary, we believe that the apparent requirement to limit the exposure of an individual member to individual asset classes should be removed, provided that there is a framework in place to manage that exposure and alert the member to the risks that they may be assuming on their own account.

In cases where these asset class options are well designed, well- diversified and offered within a coherent investment choice framework, it is impossible for the trustee to second-guess the intent of investors that may well be factoring in membership of other superannuation funds, exposure to other non-super investments, or may have informed beliefs on the outlook for particular markets.

For large funds wishing to offer both diversified and single asset class or sector options, a significant factor safeguarding diversification at the fund level is that only a minority of members are likely to choose to invest in a more sophisticated investment manner, using single asset class options and undertake their own mixing of their investments in the fund.

Those who wish to choose single asset class options and to mix their own portfolio have to make an explicit choice to do so, with communication material specifically and clearly advising the risks of their choice and of the options within that choice.

Assuming that a high-level framework as outlined above is in place to “stream” and/or default unsophisticated investors into pre-mixed diversified options, we would suggest that the minority of sophisticated investors should be able to operate their options with minimal constraints, as they are more likely to be considering and investing in their superannuation as one element of their total asset position both within and outside the fund. To constrain the member, for example by placing limits on the proportion they can direct into a single asset class option, undermines the point of offering the single asset class in the first place.

We also believe the requirement (implied in paragraph 39) to individually rebalance member’s portfolios is unworkable as it imposes significant cost and administrative burdens on the funds providing this service. Furthermore, it could run contrary to the individual investment strategies being applied by members. The most appropriate

mechanism in this regard is to ensure that members are made aware that they are responsible for rebalancing their strategies as part of the communication to members choosing these strategies.

3.4 Paragraph 49

The reference to a closed defined benefit fund requiring a more conservative investment strategy should be removed. This may be the case, but in some situations it may not be appropriate (E.g. A substantial surplus in a fund.)

3.5 Paragraph 56

It isn't clear to us whether the reference to "due diligence" is in relation to the investment strategy or implementation of the investment strategy. This paragraph may need to be revised to clarify the intention.

3.6 Paragraphs 89 to 91

It isn't clear why these paragraphs are required in this circular. They relate to matters outside the scope of an investment strategy.

3.7 Paragraphs 92 to 94

These are key requirements to be considered in formulating an investment strategy and investing superannuation fund assets. Consideration should be given to raising these matters earlier in the circular.

4 CONCLUSION

The superannuation circular is a valuable contribution to the investing of superannuation fund assets. It raises a number of matters that are currently not universal practice. These are:

- The need for the investment strategy to take into account the "whole of fund" situation; and
- The need for diversification at member level.

While we support the first of these, subject to clarification that the whole of fund situation encompasses a number of sub-sets of objectives and strategies, we are opposed to the second.

If the APRA circular promotes an active debate on these matters then a valuable contribution will have been made.

Corporate Superannuation Association

20 October 2005