



2014 brings change



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It is 6 months now since a new Commonwealth Govt. under Tony Abbott was elected. But how the landscape has changed:

- A deteriorating budget position has led to Treasurer Joe Hockey warning of the need to reduce Government outlays and to bring a new focus on longer term structural changes.
- The Financial System Inquiry, the first in 16 years, has the potential to drive improvements in regulation and effective and efficient operation across banking, insurance, asset management and superannuation, with the latter pool of funds now sitting at \$1.8trn in full view.

But there are several reasons for optimism:

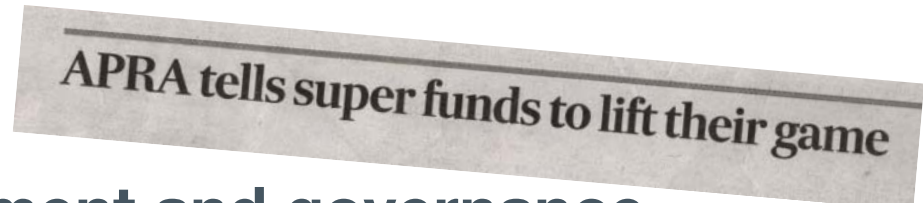
- While general business confidence has been subdued and economists worry about the lack of business investment to replace the sharp falls in mining investment, Australia's GDP growth for the December quarter surprised on the upside at 0.8% and 2.8% for the full 2013 year.

- The Australian dollar has come back from a high against the US dollar of 1.09 to around 90 cents, improving our export and tourism competitiveness.
- The A\$'s return to more sensible levels has also fed directly into magnifying already stellar overseas investment returns over the last 18 months. Domestically too we have been enjoying the best equity returns for many years. This has helped restore some superannuation fund member confidence.
- Prior to his standing aside as Assistant Treasurer, Arthur Sinodinos commented on the desirability of superannuation funds playing a bigger role as capital providers in infrastructure funding, thereby potentially better matching members' long term investment needs.

The only constant is change!

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Upping the ante on risk management and governance



The bar for good and best practice for risk management and governance continues to climb higher. Consumer and regulators' ever increasing expectations drive this off the back of periodic poor, misleading or self centred behaviour by a minority.

The superannuation industry is feeling this left, right and centre

at present. This is driven partly from those in the industry who see many of its players experiencing order of magnitude changes in size (funds under management, number of employees) and in complexity in terms of the range of products, services, providers and supporting infrastructure.

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About McGing Advisory & Actuarial



McGing Advisory & Actuarial (MGAA) is a boutique consultancy led by Sean McGing providing a personalised consulting service to directors, senior leaders and executives, and their support teams. Sean is supported by a number of experienced employees and associated consultants who partner with Sean to deliver quality, valued advice.

MGAA has four areas of focus, with considerable overlap

- Superannuation & wealth management
- Enterprise risk management (ERM)
- Boards
- Actuarial consulting

Upping the ante on risk management and governance *(Continued)*

Two recent developments which illustrate this are:

Treasury's superannuation fund governance discussion paper

The government's intention is to align governance structures in the superannuation system more closely with corporate governance principles e.g. ASX, APRA guidance. One element is reducing the regulatory load. Another major focus is ensuring the appropriate provision of independent directors on superannuation trustee boards. Industry, retail, corporate and public sector funds have quite different director appointment arrangements and many industry participants have passionate views of what is best for their funds' members. This debate is important in highlighting the advantages for good fund governance and risk management - clear formal board governance processes, independent thought, a diversity of skills and views, and transparency. It is early days...

APRA's Superannuation Prudential Standards

While superannuation funds' immediate reaction may be one of frustration to the imposition of further regulatory workload, the reality is that the core elements of these standards have been in place in the banking and insurance industry for many years and have proved their worth. Trustees of superannuation funds can maximise the benefit from their impost by focussing on how they

with Helen Rowell, APRA Member and Shaun Dooley, EGM Enterprise Risk & Chief Credit Officer at NAB. Key points emphasised were:

- Risk culture is an integral part of a modern risk management framework relating to how people behave and interact with risk processes.
- Trustees needs to ensure the behaviours across the organisation are appropriate to the desired risk culture that is necessary to support strategic objectives.
- Good governance, good risk management and a sound risk culture are interdependent.
- Both CPS 220 (applicable to ADIs (banks etc) and insurers) and SPS 220 (applicable to Registrable Superannuation Entities (RSEs)) require the institution to:
 - Maintain a risk management strategy that must outline "the approach to ensuring all persons within the institution/RSE Licensee have awareness of the risk management framework and for instilling an appropriate risk culture across the institution/RSE Licensee's business operations".
- CPS 220 further formally requires boards to:
 - Ensure that a sound risk management culture is established and maintained throughout the institution.

This further requirement for the Boards of banks and insurers to establish and maintain a sound risk management culture is a clear indication of the high level of importance that should be attached to achieving a sound risk culture, and I see it as a sign that this expectation will increase further for superannuation funds going forward.

- The Board has a role and responsibility to set the culture of the organisation.
- The key leadership actions that shape that culture are:
 - What the leader attends to, measures, rewards and controls
 - How the leader reacts to critical incidents
 - The leader's role modelling
 - The criteria for recruitment, promotion and retirement.
- A clear and unambiguous risk appetite is very important in driving an effective risk culture. Espoused values - what the Board says the organisation stands for - need to be consistent with the risk appetite and business strategy. These values must be embraced, evident to all and used in decision making.

As APRA member John Laker commented in the media release accompanying the final CPS 220 on 31 January "APRA is much more focused today on the quality of institutions' risk governance and its risk culture. Our enhanced risk management requirements will help to reinforce that focus."



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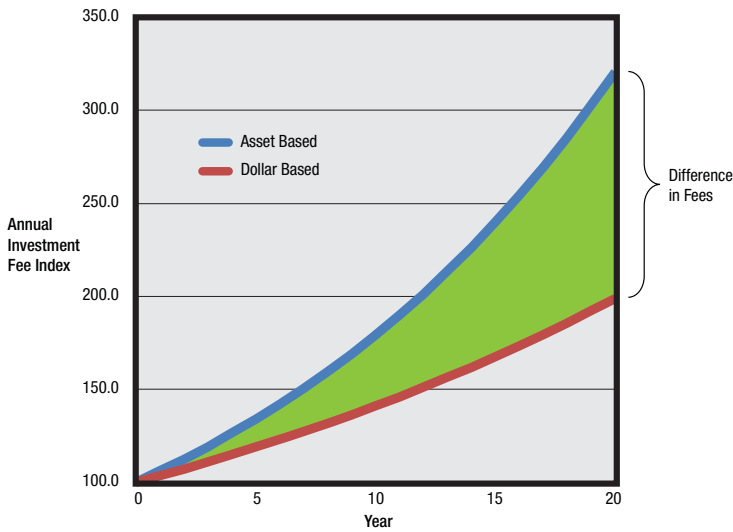
can take this opportunity to improve management of risk across the entity, resulting in better performance in service and returns for their members.

A core component is to embed a sound risk culture in the organisation. In November, I shared a platform at an Actuaries Institute Insights session in Melbourne on this specific topic

McGing Advisory & Actuarial moves office

After 3 years at Equitable House in Little Collins St, we have moved 300 metres to level 13, 160 Queen St. We have taken extra desk space to facilitate our hiring of two part time analysts to support the efficient delivery of our advice. We have also gained access to training facilities to enable us to conduct risk management and leadership workshops at our offices.

Commentary : In 2011 I wrote a paper for the Actuaries Institute Convention entitled Reducing Retirement Income Costs. One of my recommendations was: “Investment costs for retirement income could be reduced by setting base contracts in dollars not % of FUM.”



Graph 1. Comparison of Dollar to Asset Based Investment Fees

The principle applies to all asset management where assets are increasing in value over time. In superannuation this situation is further magnified by contributions increasing over time with wages.

Graph 1 illustrates the big difference in fees paid by charging a member on a percentage of the asset value compared to a fixed dollar basis after allowing for increases in inflation. By the end of 20 years, on a relatively conservative basis - see below - a member's annual fee if asset based is double that of a wages inflation adjusted dollar fee.

Assumptions:

- (i) Single accumulation amount invested at start.
- (ii) Asset allocation based on APRA data for average of all APRA supervised funds.
- (iii) Projected future average net investment return of 6% per annum after tax of 15%.
- (iv) CPI inflation of 2.5% plus 1% additional real wages growth = 3.5% total wages/life style growth.
- (v) Investment fee index of 100 at start = \$300 which equals 0.6% of asset value of \$50,000.

Courage - the touchstone of leadership



Andrew Brown
Owner and Director lead.first

On a 2012 trip to Atlanta with my wife, we visited the Martin Luther King Jr. (MLK) Memorial museum. Expecting to spend a short time browsing, we walked out seven hours later with a deeper sense of what courage means and how it enriches and catalyses the capacity to lead.

It is often said that “courage is not the absence of fear, it is the choice to act in the face of fear”. MLK taught me that great courage goes way beyond choice in the face of fear. It involves choice that may lead to significant

personal loss and ultimately means putting the greater good ahead of yourself.

This led me to a hypothesis – that there are various levels of courage that we can develop. These follow a pathway towards a greater contribution to others, an increasing influence on our world and an increasing capacity to shape the future.

Level 1 - Unconscious courage

Unconscious courage may be displayed through absence of personal fear in a situation that many others may fear. This can be both uplifting (I take on a risk easily that others may not be prepared to take)... and reckless!

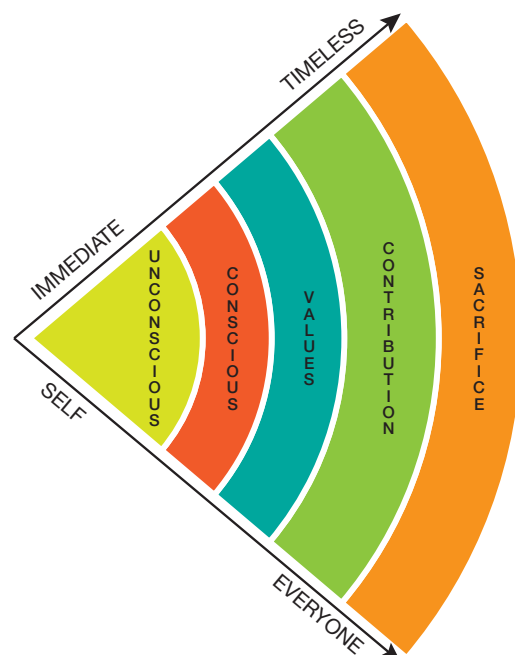
For professionals, Level 1 courage may be taking on a new project or assignment that we have not done before but builds on our existing experience.

The opportunity for the Level 1 courageous acts in your life is to accept with grace that we all do act with courage – it is what gets us through the day.

Level 2 - Conscious courage

At Level 2, the courage is a conscious choice where the consequences are likely to affect only you, and the perception or brand or reputational risk to you is quite low and will in any event only last fleetingly.

Level 2 courage may be asking for a promotion, seeking more challenging assignments, requesting feedback, speaking in public, presenting to a Board or openly challenging a different perspective.



Courage - the touchstone of leadership *(Continued)*

Level 2 courage can be developed through taking small steps, gradually expanding your level of comfort until you have greater capacity to act and respond than you could have imagined.

Level 3 - Values

At this level, courage becomes more about making a stand for what you believe to be right. At this level, the belief that you are acting with integrity is more powerful than the fear of potential consequences.

While there are potential consequences, at Level 3 these will have impact on your immediate circumstances, but in the longer term will likely be insignificant.

Level 3 courage may involve providing the bad news that your boss does not want to hear.

To develop Level 3 courage requires a strong sense of self and a clear set of values by which to live. It also requires the preparedness to act when those values are at risk.

Level 4 - Contribution

At Level 4, courage is about taking a bigger perspective than your own gain or loss. Your actions may have impact and ramifications well beyond yourself or your current reputation to family, colleagues or stakeholders. At level 4, courage is not an occasional random act; it is a way of living.

Level 4 courage is truly aspirational. One of the great ironies of life is that as we take on greater challenges and act more courageously it often opens up ever greater challenges that can only be faced through further increased levels of courage.

Level 5 - Sacrifice

At Level 5, courage is being prepared to pay the ultimate price for your beliefs. It is the awareness that the acts of greatest courage



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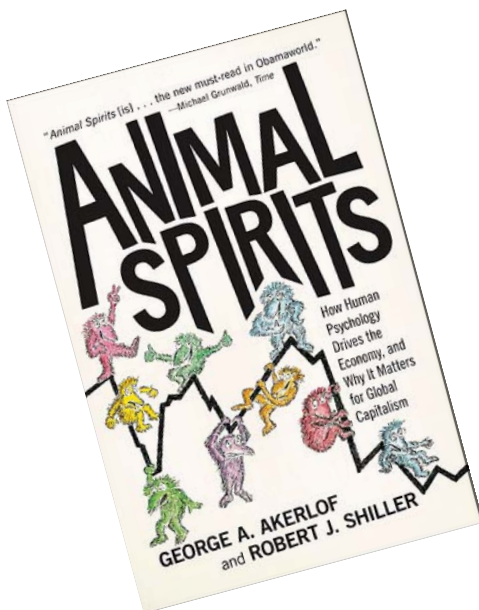
and selflessness today will shape the emerging future. The ultimate courage is an act that allows your legacy on this planet to live well beyond you for the benefit of others. MLK had that courage.

What level of courage is needed in your workplace? What level of courage do you aspire to?

- Based on an article by Andrew Brown first published in "Actuaries" magazine.

Andrew and Sean provide training, support and advice on leadership and risk management to Boards and senior management. Courage plays a critical role in the effective operation of any Board or senior management team.

Words of Wisdom - Animal spirits



"Animal spirits - our sense of confidence, of fairness, of good faith, of realistic valuations - drive the economy."

- George A. Akerlof and Robert J. Shiller

(from their 2009 book "Animal Spirits: How Human Psychology Drives the Economy, and Why It Matters for Global Capitalism.")

Comment: Shiller won the 2013 Nobel Prize in Economics, ironically shared with two other economists with very different views - Fama and Hansen. Shiller is a firm believer in John Maynard Keynes' view that markets are moved by animal spirits rather than rational assessment. Applying this to superannuation and asset management, it is important for investment related decision making to consider asset valuations from a behavioural finance perspective as well as taking the rational and quantitative economic view.