

DISCUSSION PAPERS FOR ASFPNG MEETING 13 OCTOBER 2005

1. Crediting Rate Policy

Background

A general policy on creditation has been formulated in a letter to ASF's by the Central Bank last year. Unfortunately this does not go far enough.

Performance measurement and creditation formulae of superannuation in PNG are at its infancy. Superannuation funds on the whole tell members what interest rate they are crediting to their accounts, and the prevailing mindset is that what is credited is the actual return to the Fund. In reality, the return composition can be both current income and reserve income from previous years. A further complication arises in that some of the funds historically calculate their return on the opening members account balance from the previous year. This anomaly was probably the result of unsophisticated technology, not enabling time-weighted returns. The result of this method was that crediting rates were overstated by upwards of two – to three percent.

Opening Balance Methodology against International Best Practice – An Example – 2.9% variance

Example only	O/B Method	International Method
	Opening Bal	Ending Balance
Income	30,000	30,000
Fund Size	150,000	200,000

Crediting Rate	20.0%	17.1%
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Recommendation: Reporting of Returns

In reporting returns to Fund Members and the market place, it is expected that Fund and member returns will be

- Calculated on a time weighted basis only
- Crediting Rates calculated on the opening member balance method is not allowed under any circumstances
- Crediting Rates calculated using this method including any past performance data in annual reports or marketing literature **must** always be expressed with a disclaimer that it overstates the real return by upwards of 2-3%.
- If reserves have been used in the a creditation, the amount of the accreditation attributable to reserves is also to be stated as a percentage
- Member accreditation figures are to be reported net of tax and fees

Recommended Disclaimer: “Up until 2004, the Fund’s crediting policy was based on creditation on the Members previous years opening balance. This had the effect of overstating real returns by upwards of 2%. From 2004, the Fund uses the international standard of time weighted method of creditation.”

Recommendation to Central Bank: That a subsequent letter to *Annual Crediting for Members: Guide for Industry* dated 22 February 2005 written by the Central Bank be sent to all ASF’s seeking their compliance with the above

2. In house transactions – loans from service providers & related entities to ASF Directors & Officers

Background

This paper recommends that all loans or other benefits given to Directors and Officers of an ASF by their service providers or associates be fully disclosed in public reporting. While we fall short of suggesting that any improper motive has occurred in service providers giving loans to Directors and Officers, it never the less opens an organisation to allegations of “soft loans” and or loans being organised to maintain business relationships. In such cases it could be argued that Directors or Officers are unable to fulfil their fiduciary duties due to the fact they have a conflict of interest. This leads to another important point in that if the service provider is recommending any investment, to Directors and Officers who have loans outstanding with the service provider, they should be required to disclose this potential conflict of interest in the minutes.

Further, it is currently possible to circumvent section 75 of the Act regarding lending money of the ASF to a member of an ASF. If the investment manager to an ASF borrows money from the ASF (normal loan deposit fixed for say five years) and then uses that money within their group of companies to finance loans to members or to Directors or Officers, then effectively by the use of the service provider as intermediary this section is rendered ineffective.

Recommendation:

That all benefits (including loans) by a service provider to Directors and Officers of an ASF be fully disclosed on an annual basis to the Central Bank and recorded in the minutes of an ASF and in Annual reports as a minimum.

Recommended wording Prudential Standard 1/2004

21) (B) Financial accommodation to Directors and Officers by a Service Provider and or its related entities

All loans and benefits given by a Service Provider or related entities of a Service Provider to a director or officer of an ASF must be disclosed to the Central Bank annually and reported in the Annual Accounts of the ASF.

21) (C) Loans to a Service Provider or related entities from an ASF

All moneys lent to a Service Provider or related entities by an ASF must not be converted into loan funding for members of that ASF through Service Provider.

3. Prudential Standard 2/2004 Part 111 (9) – Stating fees of service providers

Background

This paper is in support of public disclosure of all fees paid to service providers as stipulated in the prudential standards. We believe that the standard is deficient in that it does not define what constitutes the fees of the investment manager. NASFUND recommends that fees be defined as

- Investment Management fees
- Brokerage and commissions on purchases and sale of assets
- Commissions, fees and brokerage on placement of short or long term money on deposit or on treasury notes and other fixed interest.
- Sub underwriting fees

Recommendation: That the prudential standard 2/2004 be amended to define what constitutes investment management fees. Further that any brokerage/commission earned by a service provider must be refunded to the ASF.

Recommended wording Prudential Standard 2/2004

Part 111 (9) (iv) States the amount of the fees as well as fees, commissions received, rebates, sub underwriting not rebated back to the ASF.

Recommendation to Central Bank: That a letter be sent to all Service Providers stating that all commissions received, rebates, sub underwriting fees in relation to transacting business on behalf of an ASF must be rebated back to the ASF.

4. Prudential Standard 1/2004 Limit on In house Assets

Background

Under the current standard, the definition of in house assets includes an employer that makes contributions to the ASF in respect of employees that are members of the ASF (S24(c)(7)(ii) & (iii)). This has the effect of limiting any equity investment either listed or unlisted or loan investment to a company that contributes to the Fund. Taking NASFUND for example, over half its investments are with related parties under the current definition. Clearly this was not the intention of the standard and was an oversight in the original drafting of the standard. Similarly as by the current standard definition of what constitutes “in house assets” POSF would no longer able to invest in treasury notes and government securities.

Recommendation: Removal of the reference to “employers” under S24 Standard 1/2004

5. Prudential Standard 2/2004 Part 111 10) – Donations

Background

Superannuation Funds are continually being asked to donate money to various causes and community pressures tend to be very great in this regard. While it is a moot point on whether superannuation funds should in fact donate to any cause as it tends to go against the western view of “sole purpose,” never the less the cultural norms and expectations of the society suggest there is a place for donations within reason. It would be reasonable to suggest that whether superannuation funds donate to causes or not and to what extent and to whom should be left to the Boards of each ASF to decide.

This paper centres on disclosure. It could be argued that donations should be disclosed in annual reports and public reporting. There should be a full breakdown of the amounts donated and to whom. It is then up to the ASF Members to assess whether the amounts are fair and reasonable.

Recommendation: That the prudential standard 2/2004 be amended to ensure that in annual reports and public reporting that there is a full itemised disclosure of donations by an ASF.

Recommend wording for Section 10 (b) Part 111 Standard 2/2004: the donations undertaken for the financial year for an ASF be disclosed and itemised in the regular report that the ASF makes to members.

5. Free market of employment in industry policy – best practice paper

Background

There have been a number of complaints by people working in the industry (both service providers and superannuation funds) of unfair employment practices that “wed” (restraint of trade) staff to their employer and effectively punish staff if they decide to move to another organisation in the finance industry. There have been instances of employees been denied the ability to work for up to six months as a result of resignation. In one recent instance, an employee of one service provider was sacked by his employer and still forced through a restraint of trade provision in their contract not to work for six months.

The inclusion of six-month restraint of trade provisions in employment contracts is generally outlawed in the western world. Restraint of trade provisions in Papua New Guinea could be described as immoral as at the best of times professional employment is difficult to obtain through a small employment market and employees will inevitably sign away rights to ensure employment.

Restraint of trade provisions if they continue or be deemed acceptable will have an adverse effect on the industry with the potential that all service providers and licence holders will follow suit.

From NASFUND's perspective the maximum restraint of trade provisions should be no more than a month. This is an adequate time frame for an employee to sever links with an employer and for the employer to build or maintain continuous links with clients or internal work practices and flows.

Recommendation

That the Association recommends an industry policy to a maximum one-month restraint of trade provision in any staff resignation. In the advent that a restraint of trade provision is included in an employees contract and the employee is subsequently dismissed, the restraint of trade provision becomes void.

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