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Almost three years after the emergence of the global financial crisis, financial services professionals and policy makers continue to grapple with the after-effects of the crisis. Financial markets continue to be affected by uncertainty about the strength of the global recovery and debate persists about the existence of a ‘patchwork’ or ‘two-speed’ economy domestically. The current issue of JASSA addresses some of the key top-of-mind issues for regulators, investors and industry professionals in the face of these ongoing challenges.

Martin Wheatley, who is due to become CEO of the UK’s Financial Conduct Authority on 1 September, highlights the need for regulators to rethink investor protection in an environment of rapidly growing product complexity. Noting that a rear-view mirror approach to market regulation will mean that the market will always get ahead of regulation, he indicates that investor protection work calls for the exercise of foresight, and the power to act pre-emptively. He indicates, however, that the interventionist approach will be a challenge and a novelty, and that regulators will need to ensure that this new power to intervene does not distort the incentives or create moral hazard.

The paper by John Evans F Fin and Michael Sherris F Fin examines the impediments to the development of a life annuity market in Australia including the major risks associated with the issuing of lifetime annuities and the lack of markets to hedge these risks. Evans and Sherris note that the management of these risks is complex and that the lack of developed risk transfer mechanisms is a concern that needs to be addressed. Indicating that there are three broad solutions to developing a sustainable annuity market for retirees on a cost-efficient basis, the authors conclude that there are strong arguments for government support for a longevity bond market including the issue by government of survivor or longevity bonds.

Research by Graham Bornholt and Mirela Malin SA Fin examines whether volatility considerations can be used to improve on the profitability of the standard momentum approach to investing in equities markets. With the momentum effect continuing to be a major unresolved puzzle of capital markets, sustaining almost two decades of research, this paper highlights that a simple modification to the popular momentum strategy applied to international market indices produces highly profitable results in emerging market indices.
Justin O’Brien F Fin examines the legal and policy implications of the implosion of the securitisation market internationally and argues that comprehensive reform cannot be left to the courts. His paper highlights the limitations of the current legal framework by evaluating the US settlement reached by Goldman Sachs following SEC proceedings against it. O’Brien suggests that the reform agenda must address, comprehensively and directly, the ethical deficit at the heart of global finance and that this must be legislatively determined.

The paper by Monica Guo Sze Tan and Marie-Anne Cam addresses the important issue that despite the significant role of superannuation funds in maintaining the sustainability of national retirement schemes, little is known about their governance structure. Their research indicates that very few Australian superannuation funds voluntarily disclose information about their main controlling body — the board of trustees. The authors find that more highly qualified trustees are related to better levels of voluntary disclosure of their background profile, and that independent trustees and trustees who have a higher number of outside directorships have a strong positive effect on levels of voluntary disclosure.

And, finally, with the financial planning sector in Australia and elsewhere moving towards professionalisation, Kym Irving SA Fin, Gerry Gallery, Natalie Gallery and Cameron Newton report the findings of their study which seeks to understand how financial advice contributes to consumer well-being. Their results indicate that the process of financial planning is potentially supportive of individuals’ well-being at a number of levels, not just the financial, and that this occurs when clients feel engaged with planners who are professional and client-focused.

The papers in this issue of JASSA take a deep-dive into some of the key issues in applied finance currently facing the industry, and the insights that they provide will undoubtedly lay the groundwork for further debate and research in these areas. I would encourage you to contribute to a future issue of the journal, to help us continue to encourage and share important new learnings within the industry.

Please note that the guidelines for submission are available at www.finsia.com and any comments on these or any previous articles in JASSA are also welcome at m.fahrer@finsia.com.

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Using the rear-view mirror alone in regulating the market means that the market will always get ahead of regulations. As product complexity is growing at an ever faster pace, investor protection work calls for the exercise of foresight, and the power to act pre-emptively. However, we must be careful that the new power to intervene does not distort the incentives or create moral hazard.
The world’s central bankers get together each year in Jackson Hole in the United States to discuss the global economy. They met in 2005 for what was to be Alan Greenspan’s last year as Federal Reserve Board Chairman. Most of this event in 2005 was dedicated to celebrating the ‘great moderation’ that financial markets had achieved; the plentiful supply of credit that was now available and boosting global growth — but which had happened with ‘no greater risk in the system’.

Only one economist, Raghuram Rajan, dared to ask the question, ‘Has financial development made the world riskier?’ and he was roundly criticised as being out of touch. He argued that risk had not been as widely dispersed as was claimed, that the banking system itself could be at risk, and that the bond market could freeze up and a full-blown crisis could emerge.

Among regulators — the Financial Stability Forum (FSF) (the forerunner of the now, more powerful, Financial Stability Board) was charged with the task of reviewing risk build-up in the system. The FSF was given this role following the collapse of Long Term Capital Management (LTCM) — the hedge fund that, despite employing Nobel prize winning mathematicians, came close to bringing down the financial system. Even as late as early 2007, the reports from the FSF were still saying that although risk appeared to be underpriced, the process of securitisation had left banks carrying a relatively small but manageable portion of that risk; and, that if a crisis were to emerge, it would probably come from ‘the less regulated hedge fund sector’.

Despite a few lone voices, regulators generally failed to appreciate the scale of the crisis that would ensue.

The fallout in each market was different. In Hong Kong, Lehman was not a particularly big player overall in the market. It had, however, packaged a complex product — known as a Minibond, which I shall come back to later — which had been widely sold to retail customers via the banking system.

The challenge now being presented for regulators, policy makers and supervisors is that we must ensure that we ‘never again’ face a crisis like this. The nature of financial markets is that they are about pricing risk and taking risk. And, inevitably, that means failures, whether at a product or entity level, are a fact of life. To take risk out of the system would undermine the economy more widely. It is NOT that there should never again be a failure — BUT that any failure should not be allowed to impact in the way that this crisis has. A lot of this debate is about the ‘too big to fail’ problem — how to ensure that financial institutions take less risk, hold more capital — and do not become a burden on the taxpayer.

The other part of the debate on ‘never again’ is about products — complexity of products, suitability and the risks to which they expose the holders of these products. This is the part of the debate that I shall focus on — how to make sure that products are appropriate. It’s a subtle and difficult debate. Most products are not inherently good or bad (unless they are fraudulent). But they have become very complex in areas where the balance of risk and reward can be opaque — products unsuitable for some may be entirely appropriate for others. ‘Credit’, as a product, was widely packaged and sold in Hong Kong — it’s probably not appropriate for 100 per cent of your investments but could be a diversification play in a broader portfolio.

As I mentioned earlier, investor protection is a fundamental part of the responsibility of securities regulators. I have a perspective on this based both on the past six years regulating the Hong Kong market, and on my next job. I’m returning to the United Kingdom in September to help set up a new, purpose-built conduct regulator — the Financial Conduct Authority (FCA) — and to head it once the legislative process is completed. I will therefore have the chance to help shape the creation and direction of the new body.

The FCA is one of the three new bodies to be created under the UK Government’s current reforms of financial regulation, the other two being the Financial Policy Committee (FPC) to be set up in the Bank of England and the Prudential Regulation Authority (PRA).
From spaghetti approach to packaged solutions

I would categorise the regulatory response in the aftermath of the financial crisis as the spaghetti approach—a vivid description of the strategy of throwing ideas against the wall to see what sticks.

Governments and regulators, placed under immense pressure to act, had brought out emergency rules that were later reversed, creating further problems rather than eliminating them.

Just recall the assorted bans on short selling in different markets, which hurt rather than helped the markets by disallowing legitimate strategies, choking off the much-needed liquidity in the markets.

Crisis often opens a window of opportunities to forge ahead with necessary, sometimes overdue, reforms. I am hoping that the relative calm at present, with markets on the mend from the damage sustained in 2008, will enable more rational, balanced debates and decision making regarding regulatory issues.

When I was last in Australia for the ASIC Summer School this February, I had the chance to update myself on how the Twin Peaks model has served the Australian market. No market around the world escaped the crisis unscathed—but, in a scenario in which major financial institutions collapsed and billions of dollars of taxpayers’ money were needed to shore up the system in some markets, the Australian Twin Peaks model has served the market well.

In late 2008, when regulators in Hong Kong were tasked with producing a report to the government to suggest ways to improve the regulatory system, I found myself a proponent of the Twin Peaks model for Hong Kong. After considerable deliberation, Hong Kong decided that it would not go so far as to dismantle the current regulatory structure to make way for two new regulators.

Instead, a package of measures has been introduced to enhance investor protection, covering both products and conduct, and spanning the three key stages of an investment—pre-sale, sale and post-sale.

For example, we have mandated an easy-to-read product key facts statement to help investors understand the key risks and features of a product. Certain unlisted structured products must also now offer a minimum cooling-off period so that investors have a chance to unwind the investment in a completed transaction.

On the other hand, the United Kingdom drew a different conclusion and resolved to follow Australia’s model to run a prudential and a conduct regulator in parallel. Where you have the ASIC and APRA here, the United Kingdom is in the process of creating the FCA alongside the Bank of England’s FPC and the PRA: these will replace the current FSA integrated regulator approach.

While global regulatory structures may converge and diverge, the common, fundamental objectives remain the same—the protection of investors, and maintaining a safe and sound market. In the United Kingdom, the responsibilities of achieving these objectives fall squarely on the FCA and PRA.

Conventional wisdom about investor protection

Disclosure, based on the belief that sufficient information enables sensible decisions, and conduct regulation, which imposes suitability requirements and addresses conflicts of interests issues, often go hand-in-hand in investor protection regimes.

A recent survey conducted by Fidelity International shows that 78 per cent of Hong Kong investors think ‘investor protection’ is to provide investors with the appropriate information before making an investment decision; this is fair enough and rather encouraging.

But, in the same survey, 59 per cent said they would not read the prospectus and 64 per cent said they would not read fact sheets or product brochures. It’s a bit worrying as a regulator that puts an emphasis on disclosure, if most people don’t read what you disclose.

Hong Kong is among the many markets that have beefed up conduct regulation in the light of mis-selling allegations. It means that the sales process takes longer and is more intrusive. It requires the bank to have a better understanding of client needs and to spend more time explaining product features. However, as the survey indicated, to avoid the additional selling process, 32 per cent changed their investment from mutual funds to risky or riskier investment products that are less regulated. So the investor choice (or possibly the bank, if I am really cynical) is to opt for the riskier products to avoid the time involved in extra regulation.

Loads of information, none the wiser

These perplexing, worrying findings have driven me to venture into consumer psychology. At the ASIC Summer School, Dr Paul Harrison of Deakin University quoted Stephen Pinker, author of How the Mind Works, in which he sums up human behaviour rather well, saying: ‘Humans are impatient, intelligent beings’.

Dr Harrison went on to explain that we are drawn towards information that is easily accessible, fits in with our current worldview, requires little cognitive resources, and is easy to understand.

If we are tired, stressed, confused or struggling, we are likely to use peripheral, emotional, social and impulsive cues, such as trust, inertia, or external stimuli (e.g. perceived relationship with the person selling a product to us) to assess whether we are making a good decision.

 Provision of choice brings benefits insofar as decision complexity is manageable; otherwise too many options are likely to result in suboptimal decision making.
The toxic mix of mis-selling and mis-buying

The Fidelity survey has turned out another interesting finding: investors expect to achieve an average return on investment of 17.2 per cent per annum from their investment portfolios. This is a troubling figure if you want to stem both sides of the problem — mis-selling and mis-buying.

But it was not just retail investors who got entangled in disputes over complex financial products. Nor did they happen in isolated markets.

As many as half a dozen Italian municipalities have been embroiled in lawsuits with investment banks over swap contracts that had turned sour. Derivatives losses sustained by Italian local governments, by one account, were up to some 1.2 billion euros.

Plausibly, one might argue, all of these massive failures have to do with the fact that retail investors and municipal governments lack the sophistication to handle increasingly complex financial products.

But corporations have also got their fingers burned in derivatives transactions.

In a lawsuit between a German corporation and its bank over an interest-rate swap transaction, the court ruled that the bank had not adequately explained the risks to the firm. The presiding judge mused that, ‘If you are able to read the words of a poem, you haven’t necessarily also understood its meaning’.

It is also wrong to think that these failures afflicting individuals, governments and corporations were the collateral damage of the global financial crisis. This is not a recent phenomenon. Just look at the following case which took place in the mid-1990s.

Bankers Trust, the name associated with the pioneering of derivatives trading, was sued by a number of major corporate clients which ran sophisticated treasury departments, including Procter & Gamble.

Have creative product design and selling gone one step too far? Were these isolated shenanigans pulled off by rogue, greedy sales?

Disclosure, conduct and beyond

With the basic belief in free markets, most regulators have so far kept away from direct intervention. We know merit-based regulation is a murky territory, and could potentially create moral hazard. In a merit-based system the regulator would approve products. Once approved, does that mean they are safe? And, if so, are they safe for all consumers, in all conditions?

Product intervention may take the form of rules placing requirements on products and product features; mandating minimum product standards, and restricting sale of a product to a certain class of consumers.

In Hong Kong, we have published a consolidated product handbook, which includes a new product code for unlisted structured investment products.

But intervention can go further than that.

It is also possible for the regulator to go in before the problem occurs, trying to spot any potential build-up of risk and risky products before they cause any damage.

Acting before damage has occurred is not easy or straightforward. It is quite a challenge which requires judgement calls to be made about what’s good and what’s bad in markets. Ideally, a large part of the intervention work should fall on the proactive scrutiny of the products market. However, the regulator must also stand ready to act in order to stop major problems in their tracks.

Many investment products have become excessively complex, and doubts exist as to whether they make any meaningful economic sense. In some cases, due diligence is not only beyond investors; it is probably safe to assume that intermediaries selling these products or advising their clients on these products find it impossible to grasp the structure of these products.

In a 2009 speech, Andrew Haldane of the Bank of England reckoned that an investor in a CDO squared — synthetic collateralised debt obligation squared — would need to read in excess of one billion pages to fully understand the ingredients.

When comprehension of a product is lacking even among the professionals, it is hard to put forward a convincing case as to how the product can benefit the investor.
As inflation is now creeping into most economies with interest rates failing to catch up, investors would be attracted by the higher returns of investment markets as they seek to preserve their wealth. This could be a recipe for another bubble to form.

An added pillar, a more balanced approach

Knowing that the flipside of intervention is the potential risk of moral hazard, any regulatory framework that provides for intervention must, at the same time, highlight the importance of consumers’ responsibilities for their own choices.

Intervention is a fundamentally different approach from the way that most regulatory regimes have operated to mitigate the risk of financial services.

Regulators may proactively intervene earlier in a product’s life cycle, and exercise greater scrutiny of firms’ product design and product governance. A more proactive, interventionist approach will also require a greater use of judgement.

This is done to complement, not to supersede, the traditional focus on sales and marketing, and the disclosure of information.

But financial markets are primarily about the management and pricing of risk, not its removal. It is therefore imperative that intervention does not make for a zero-failure regime, and that investors are not removed from the responsibility for their own decisions.

Conclusions

The interventionist approach is a challenge and a novelty. There will be a need to road-test the rules and we may even have to allow for a few false starts.

A problem averted may be visible to only the few who saw it coming. But a problem that happens on the watch of an intervening regulator could be taken as proof of a deficient system.

Using the rear-view mirror alone in regulating the market means that the market will always get ahead of regulations. As product complexity is growing at an ever-faster pace, investor protection work calls for the exercise of foresight, and the power to act pre-emptively.

These powers are tools that come together as a package, with each pillar buttressing the effectiveness of the others. We are also careful that the new power to intervene does not distort the incentives or create moral hazard. Vigilance is the responsibility of both the regulator and investors.

Before the advent of complex structured products, regulatory attention was appropriately targeted at conduct issues, mainly in the selling process. But with investment banks continuing to recruit droves of mathematicians and financial engineers each year, we can expect more complex products to come on stream.

If the intention is not to throw the baby out with the bath water, then we need to make room for market development and product innovation. Accordingly, regulatory resources should be appropriately deployed to ensure dangerous build-up of risks on the product side would not be off the regulator’s radar screen.
THE DEVELOPMENT OF A LIFE ANNUITY MARKET IN AUSTRALIA: 
AN ANALYSIS OF SUPPLIER RISKS AND THEIR MITIGATION

The significant accumulation of superannuation assets must be converted into income to finance the retirement needs of individuals. This paper considers the development of a life annuity market in Australia focusing on the risk management for potential suppliers of long-term guaranteed annuity products. It also examines the role of government in this market, particularly in hedging for the major risks involved.

Australia has a three pillar retirement savings system with the first pillar being a means-tested government-provided annuity, and the second pillar being a mandated private employer contribution into individual defined contribution accounts, but with no provision for annuitisation. Voluntary savings form the third pillar.

While the need for retirement income products including life annuities is obvious, it remains unmet. There are two aspects to be considered when trying to understand the lack of demand and lack of supply of annuities: why consumers don’t annuitise; and why providers don’t create and market suitable products.

There are many reasons proposed as to why consumers may not annuitise including: constraint on supply; lack of consumer awareness of the risks of not annuitising; and bequest motives when consumers decide whether to annuitise their retirement wealth.

While we recognise that there may well be consumer reluctance to purchase long-term guaranteed annuities even if they were available, this paper does not consider these consumer issues but it looks at the potential suppliers in Australia, the reasons they may not be prepared to provide attractive long-term annuities, and potential solutions. The paper also considers the risks involved for suppliers and whether these long-term annuity products should be solely provided by the private sector, the government sector, or some combination of the two.

Risk management for long-term guaranteed annuity products

The major risks involved in the provision of lifetime annuities are:

- investment return;
- mortality of annuitants; and
- expenses of operation.

Investment risk

The traditional life annuity transfers all the investment risk to the issuer since payments are guaranteed. With indexed annuities, both investment and inflation risk are also transferred to the issuer. These risks can be mitigated through product design with some or all of the risk being left with the annuitant.

Life annuities are traditionally matched with dedicated bond portfolios or, at least, the interest rate and inflation rate risks are minimised through hedging. The lack of hedging instruments has encouraged investment in corporate bonds and equity in order to
achieve higher returns. Variable products require complex hedging of equity and other investment classes to ensure guarantees are met.

Hedging equity assets requires the use of options or an asset swap whereby the insurer swaps the return on their portfolio to another party in return for a fixed return, or a lower volatility of return over the life of the annuity. Options to provide downside protection are available to a limited extent in the Australian market through the Australian Securities Exchange (ASX), and are available for individual equity shares or for underperformance of the market as a whole.

Longer term options are negotiated individually over the counter through an investment bank. An asset swap involves a counterparty taking on the investment risk of the insurer portfolio, as well as the risk of the average maturity of the annuity cash flows, and would need to be hedged by the swap counterparty.

**Longevity risk and pooling**

As in most developed countries, longevity in Australia has been improving through the past century and at rates that have been largely unexpected and significantly underestimated. Figure 1 indicates how life expectancies at birth have been increasing over the past century in Australia.

Socioeconomic group is a significant risk factor, as indicated by data from the United Kingdom in Figure 2.
A lack of natural investors to take on longevity risk results in demand and supply imbalance, and a lack of market development. The nature of longevity risk is new to financial markets and it does not have the normal properties of markets such as those for credit risks that have developed rapidly in recent years.

In a voluntary insurance market, insurers are faced with the risk of adverse selection. In a risk pool where there is substantial heterogeneity, this will result in those with a higher expected longevity purchasing life annuities and those with lower longevity not purchasing annuities. To avoid this, the insurer must undertake a risk assessment, to differentiate between those with different life expectancies, in order to charge fair premiums. This approach has led to impaired life annuities and postcode underwriting for life annuities in the United Kingdom.

Compulsory purchase of annuities avoids the problem of adverse selection but still leaves open the problem of fair pricing to reflect relative risks in a heterogeneous pool.

Mortality is traditionally assumed to be an independent risk that is managed by diversification of lives in large risk pools. The law of large numbers is relied on to reduce mortality variations to manageable levels and then capital is required to be held against the residual risk. Life annuities rely on the pooling of longevity risks to average the cost. They pool both systematic and non-systematic risks. Systematic risk arises from the uncertainty of the future survival probabilities because of common factors affecting mortality rates at future ages for a group of individuals. Systematic risks are those that affect all of the lives in the pool to a greater or lesser degree, resulting in dependence between the lives. Non-systematic risks are independent risks that have an impact on individual lives in an uncorrelated manner; this is referred to as idiosyncratic individual risk.

Over the past 50 years, the impact of improvement in mortality has mostly resulted from systematic improvements in economic conditions, better health care and better awareness and treatment of diseases, improved road safety and other factors that influence the survival of all individuals to a greater or lesser extent. Improved longevity has not just been a ‘chance’ outcome with higher than expected numbers of independent individuals surviving to older ages. The volatility in the survivors of a group of annuitants initially aged 65 has a high level of uncertainty arising from the systematic stochastic mortality.3

This risk must be managed through risk transfer using capital market products, such as securitisation, through reinsurance or having enough capital. Using such risk transfer methods for the systematic risk allows this risk to be diversified with other risks that are relatively independent of mortality risk. In the case of securitisation, hedge funds can pool risks such as capital market risks, insurance catastrophe risks and mortality/longevity risk to gain diversification of these risks at a portfolio level. Similarly for reinsurers, diversification of relatively uncorrelated life and non-life insurance risks can achieve risk reductions at the portfolio level.

The creditworthiness of the counterparty to any risk transfer is also an issue over such a long period of time. At the moment, the only protection available to issuers of lifetime annuities against adverse mortality risk is through reinsurance contracts where effectively part of the annuity is sold to the reinsurer. Attempts to create long-term longevity bonds in the alternative risk market that would protect issuers of annuities from adverse mortality have been attempted, but failed to find investors. Apart from being a complex bond structure, it is likely that the term of the bond is a deterrent as well, as most ‘catastrophe bonds’ that have been sold to the market have been around three years in duration.

As noted by the OECD,4 a lack of natural investors to take on longevity risk results in demand and supply imbalance, and a lack of market development. The nature of longevity risk is new to financial markets and it does not have the normal properties of markets such as those for credit risks that have developed rapidly in recent years.

Inflation risk
Mitigation of inflation risk arising from indexation or partial indexation of annuity payments is possible through product design by offering only fixed indexation rate life annuities, or by using a cap on the maximum level of indexation. If full indexation is adopted then life annuity providers will need to hedge long-term inflation-indexed cash flows for the maturity distribution of life annuity cash flows. This requires long-term inflation-indexed bonds or inflation-linked swaps.

Expense risk
To mitigate expense risk, ideally, an issuer of a lifetime annuity would need to hedge against adverse inflation of administrative and other costs, typically over a 30-year period. There is no capital market product available that offers protection against inflation of expenses. Product design for charging expense loadings can mitigate the risk, but even variable annuity products have to manage this risk. While inflation-linked capital market securities exist, they are relatively small in volume and could lead to reinvestment risk.

Role of private markets
The private market provision of longevity insurance products in Australia has been limited. This reflects the limited demand for life annuity products and the
significant costs faced by private markets in supplying reliable and efficient longevity risk products. There have been many proposals for private market products. Some of the products developed, such as variable annuities, although attractive to individuals, require complex risk management and can involve exotic option structures.

In the absence of viable or affordable hedging instruments for longevity, interest rate and inflation risks, private life annuity providers must hold capital to absorb adverse developments in these risks. In the insurance industry, risk-based capital is determined by APRA’s life insurance prudential standards and it is increasingly influenced by Solvency II, which is under development for insurers in Europe.

Capital can be costly to hold for insurers. Apart from the competitive return demanded by investors on capital, insurance companies have to price products to cover the risk costs of capital ranging from expected financial distress costs, additional transaction or taxation costs as well as potential agency costs arising from misalignment of the interests of policyholders and shareholders.

Solvency II includes requirements for holding capital to absorb the change in liabilities for a permanent 25 per cent decrease in mortality to cover longevity risk. This may underestimate the potential risk since there is a large degree of uncertainty around possible future mortality trends.

Capital is also required for other risks that cannot be hedged. These include inflation risks, where the life annuities are issued on a fully indexed basis, as well as interest rate risk, where Australia lacks a long-dated and actively traded government bond market and also has a thinly traded long-dated interest rate swaps market.

The private sector annuity market must manage a large number of major risks in order for individuals to be provided with lowest cost annuities. In order to allow the most efficient use of risk-based capital, the major risks faced by annuitant providers need to be hedged in financial markets. Without this hedging, the risks faced by annuitant providers are significant and highly uncertain. The major risks for life annuitant providers are longevity risk as well as the inflation indexation risk for fully indexed life annuities. Variable annuities require much more sophisticated hedging and risk management than life annuities. Although the private market would normally have incentives to innovate and provide solutions, in the longevity risk case, this is yet to happen in Australia.

The role of government: private market support

There are strong arguments for government support for a longevity bond market including the issue by government of survivor or longevity bonds. By offering both long-term CPI-linked bonds that would deepen the existing market and longevity bonds, government can provide a viable market for hedging the long-term risks facing life annuity providers and reducing the costs of the annuities, hence making them more attractive to retiring individuals.

Longevity bonds pay future returns based on an index of population mortality. They allow purchasers to receive payments based on future mortality rates for the population, as mortality changes according to published mortality tables. They do not directly hedge a particular annuity provider’s mortality risk but do so at the population level. Other financial contracts such as mortality swaps and other derivative-based and reinsurance-based contracts are required to manage the basis risk between the population mortality and individual provider’s experience, but may not manage all of the basis risk unless specifically constructed to reflect the exact risks of the insurer.

The hedging of the credit risk of financial intermediaries — including those providing risk management instruments such as derivative and reinsurance contracts — is an important issue that is now well understood following the global credit crisis. Even in the securitisation market, there have been credit impacts especially where these arrangements relied on interest rate swaps or other hedging instruments. Those securitisation arrangements that have not been fully collateralised, such as synthetic CDOs, have resulted in substantial losses for major financial players as well as investors of individual savings including retirement savings. The government has the strongest credit rating and provides the assurance of contract performance that many private sector providers will not have.

The Australian Government has issued long-term inflation-indexed securities and has the market experience and knowledge to efficiently provide underlying securities for inflation risk. Providing loans structured as inflation-indexed annuity cash flows will provide even more demand for such securities in the event of the development of a more viable life annuity market in Australia. These securities also provide the basis for the development of other bespoke inflation hedging derivative instruments that can then be purpose designed for life annuity providers.

Similar comments apply to longevity-linked securities. Although the Australian Government may not be a natural supplier of such securities because of its exposure to longevity risk through the age pension, providing such instruments and creating a viable life annuity and longevity risk market will reduce the potential future call on government revenues from ageing Australians running out of their retirement savings.
Summary and conclusions

There are significant impediments to the development of a lifetime annuity market in Australia. This paper has reviewed those impediments including the major risks associated with the issuing of lifetime annuities and the lack of markets to hedge these risks.

The management of these risks is complex and the lack of developed risk transfer mechanisms is a concern that must be addressed.

To develop a sustainable annuity market for retirees on a cost-efficient basis, there are three broad solutions:

> **Private sector:** the private sector develops an annuity market for retirees, with government support to provide or organise hedging products for the major risks involved. If government support is not provided, it is difficult to see how the private sector can develop efficiently priced lifetime annuities that would be attractive to retirees.

> **Public sector:** a public sector solution would be potentially the most efficient, provided that annuitisation is compulsory.

> **Private/public sector partnership:** a private/public combination would be feasible with the private sector providing annuities for fixed terms, such as until age 85 or earlier death, and the public sector providing a deferred annuity from age 85 until death. The private/public solution would reduce the risks for the private sector and encourage an annuity market to develop, with the longevity risk being taken on by the public sector. This solution would work with both voluntary and compulsory annuitisation of retirement funds and is likely to be the most viable approach for future policy.

(This paper is based on commissioned research for Australia’s Future Tax System.)

Notes


References


Ganegoda, A. and Bateman, H. 2008, Australia’s disappearing market for life annuities, discussion paper, Centre for Pensions and Superannuation, 01/08.


USING VOLATILITY TO ENHANCE MOMENTUM STRATEGIES

A simple modification to the popular momentum strategy applied to international market indices produces highly profitable results in emerging market indices. High-volatility recent winners outperform low-volatility recent losers on an annualised basis by 17.4 per cent, with the strategy’s long portfolio driving the superior performance. In contrast, applying the momentum/volatility strategy to developed market indices produces small but consistent improvements over the standard momentum approach.

The momentum effect, originally described by Jegadeesh and Titman (1993), is characterised by a short-term return continuation of up to 12 months, whereby stocks that have had high returns in the recent past continue to have high returns in the near future and, similarly, stocks with low returns in the recent past repeat this performance in the near future. Classified as a major unresolved puzzle of capital markets, the momentum effect has sustained almost two decades of research. Although various risk-based and behavioural-based explanations for momentum have been offered, no explanation has achieved broad acceptance (Chan et al. 1996).

Previous momentum research has often considered other variables such as size, book-to-market, earnings and trading volume. In this paper, we consider whether volatility considerations can be used to improve on the profitability of the standard momentum approach. Momentum strategies buy securities with large returns in the recent past (‘winners’) and short securities with poor returns in the recent past (‘losers’). Our approach is driven by two insights. First, average returns and volatilities are positively correlated at the level of international market indices. This means that indices with high volatility may be an advantage to the long side of the momentum strategy but may be a disadvantage to the short side of the momentum strategy. Thus, instead of simply buying winners and shorting losers, a better strategy may be to buy high-volatility winners and to short low-volatility losers. This is the strategy that we call the momentum/volatility strategy.

The second insight comes from an expression used by some stock market commentators and professionals at certain times that ‘the market has climbed a wall of worry’. The expression means that the market has climbed over a period of time despite some intervening bad news. An implication is that the user regards such a market movement as having more than the usual strength. Perhaps indices that have ‘climbed a wall of worry’ will have stronger than usual momentum. We hypothesise that an index that has recently ‘climbed a wall of worry’ will have relatively high recent volatility, because it seems likely that any intervening bad news that was overcome will have at least produced extra volatility. Thus this insight also predicts that high-volatility winners will tend to have stronger momentum than winners in general.

Literature review

Volatility has long been a subject of interest to market participants and researchers. The consensus in the financial sector over many years has been that the volatility of the market has increased over time due to: (a) improvements in the speed and availability of financial information; (b) the increased importance of institutional investors; and (c) progress in the derivatives markets. Contrary to this popular belief, studies such as
Malkiel and Xu (1997, 1999), Schwert (1989), and Campbell et al. (2001) find that there has been no significant trend in total market volatility across many decades, but that the volatility of individual stocks has grown over time (Xu & Malkiel 2003). There has also been research linking return predictability with past volatility of returns. Arena et al. (2005) have shown that stocks with high volatility display large momentum but also exhibit the quickest and largest reversals. Similarly, Wang and Xu (2009) have found that market volatility has significant predictive power for momentum especially in volatile down markets.

Malin and Bornholt (2010) use past volatility to explain an anomalous return produced by a 52-week high trading strategy.

Our present study differs from these past studies by employing a double-sorting method to investigate whether a momentum/volatility strategy is an improvement over the standard single-sorted momentum strategy.

Data and methodology
Monthly returns are derived from monthly prices with reinvested gross dividends of 44 Morgan Stanley Capital International (MSCI) indices downloaded from Datastream. Table 1 provides descriptive statistics for the returns data of the 18 MSCI Developed Markets and 26 MSCI Emerging Markets indices from their first available months (January 1970 at the earliest) until January 2011 obtained from Datatrend. Mean refers to the average monthly returns. SD refers to the standard deviation of monthly returns.

### TABLE 1: Descriptive statistics

#### Panel A: Developed Countries

<table>
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<tr>
<th>Country</th>
<th>Mean %</th>
<th>SD %</th>
<th>Country</th>
<th>Mean %</th>
<th>SD %</th>
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<td><strong>AVERAGE</strong></td>
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#### Panel B: Emerging Countries

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<td><strong>AVERAGE</strong></td>
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Note: This table provides descriptive statistics for the returns data of the 18 MSCI Developed Markets and 26 MSCI Emerging Markets indices from their first available months (January 1970 at the earliest) until January 2011 obtained from Datatrend. Mean refers to the average monthly returns. SD refers to the standard deviation of monthly returns.
Datastream. Returns are calculated in US dollar terms to facilitate the interpretation of results across markets. The timeframe for the study extends from January 1970 to January 2011. Table 1 lists all of the countries in the sample, together with the average monthly return and standard deviation of each index. To understand better the performance of indices in different global settings, the countries in Table 1 are classified into 18 Developed (Panel A) and 26 Emerging (Panel B) markets based on MSCI’s own classification.

The new momentum/volatility trading strategy proposed in this paper double-sorts indices for the two cases (developed and emerging) using a measure of momentum as the first sort variable and a measure of volatility as the second sort variable. Since momentum studies commonly use past six-month returns to sort securities into portfolios, we adopt this practise for our first sort variable. For simplicity, we use the standard deviation of monthly returns over the same six months as our measure of volatility. The strategy is constructed by buying the portfolio that contains indices that have performed well over the past six months and that have also displayed relatively high volatility (high-volatility winners), and selling the portfolio that contains those indices that have performed poorly over the past six months with relatively low volatility (low-volatility losers).

Portfolios are formed for the developed and emerging markets separately using the same procedure for each. Based on past six-month returns, every month the Winner portfolio contains the 25 per cent of indices with the highest past six-month returns, and the Loser portfolio contains the 25 per cent of indices with the lowest past six-month returns. The standard single-sorted or pure momentum arbitrage portfolio is the Winner–Loser portfolio. The momentum/volatility portfolios are derived by splitting both the Winner and Loser portfolios based on recent volatility. That is, the high-volatility winner portfolio (denoted HvWinner) contains the 50 per cent of indices in the Winner portfolio with the highest standard deviation of monthly returns over the past six months. Similarly, the low-volatility loser portfolio (denoted LvLoser) contains the 50 per cent of indices in the Loser portfolio with the lowest standard deviation of monthly returns over the past six months. The momentum/volatility arbitrage portfolio is the HvWinner–LvLoser portfolio.

We calculate portfolio returns for holding periods of three, six, nine and 12 months. Following Balvers and Wu (2006), we allow a one-month gap between the end of the ranking period and the beginning of the holding period. We also employ Jegadeesh and Titman’s (1993) overlapping portfolio method. This means that for a six-month holding period, for example, one-sixth of the portfolio is updated each month (see Jegadeesh and Titman (1993) for a fuller explanation of the overlapping portfolio approach).

Results
Table 2 presents the results of the momentum/volatility strategies for the developed (Panel A) and emerging markets (Panel B) showing the average monthly returns of the short (LvLoser), long (HvWinner) and the arbitrage (HvWinner–LvLoser) portfolios, together with their associated t-values. To determine whether volatility enhances momentum, Table 2 also presents the Winner-Loser results of the pure momentum strategy in the final two rows of the table.

The momentum/volatility findings for developed markets in Panel A indicate that the long portfolio outperforms the short portfolio for each holding period, with the highest return of 0.86 per cent per month (t-value 3.68) for the six-month holding period. Comparing these results with the corresponding pure momentum results, we observe that the momentum/volatility profits are slightly larger for all holding periods.

Panel B of Table 2 presents the results for the two strategies applied in the emerging markets. For each holding period, the profits of the momentum/volatility strategy are greater than the momentum strategy, with the highest return of 1.45 per cent per month (t-value 2.87) being earned using a six-month holding period. This profit is almost double the pure momentum profit of 0.76 per cent per month (t-value 1.82) for the same period. The entries in Panel B for nine-month and 12-month holding periods also show substantially higher profits for the momentum/volatility strategy compared to the corresponding pure momentum strategy.

A feature of Table 2 is the remarkably high returns generated by the long portfolio that is composed of recent winners with high volatility. For example, with a six-month holding period, the HvWinner portfolio earns an average return of 1.51 per cent per month (t-value 5.08) in the developed markets case and earns 2.36 per cent per month (t-value 4.36) in the emerging markets case. Investors who do not wish to adopt a long/short strategy can derive very large returns by investing only in the long portfolio of this strategy.

Risk-adjustment analysis
An important issue in this research is the extent to which any profits survive risk-adjustment. This is addressed by employing an international two-factor model used by Balvers and Wu (2006): \( R_{p,t} - R_{f,t} = \alpha_p + \beta_{p,mkt}(R_{mkt,t} - R_{f,t}) + \beta_{p,vmg}VMG_t + \epsilon_t \) (1)

The dependent variable \( R_{p,t} - R_{f,t} \) is the monthly excess return of an equally weighted portfolio of interest, whether it is the long, short or arbitrage portfolio of a strategy, where \( R_{p,t} \) represents the monthly return of portfolio \( p \) at time \( t \) and \( R_{f,t} \) is the monthly risk-free rate at time \( t \) represented by the one-month US Treasury bill return.

The independent variables are as follows: \( R_{mkt,t} \) - \( R_{f,t} \) corresponds to the excess return on the MSCI World market portfolio \( R_{mkt} \) at time \( t \); \( VMG_t \) or the Value minus
Pure momentum strategy profits are reversed within five years, whereas momentum/volatility profits are not reversed within five years. These differing post-holding period results (if confirmed in other settings) will challenge a number of existing momentum explanations.

**TABLE 2: Profitability of Momentum/Volatility and Momentum strategies**

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Panel A: Developed Markets</th>
<th>Panel B: Emerging Markets</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Holding Months</td>
<td>Holding Months</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td>Mom/Vol</td>
<td>LvLoser</td>
<td>0.75</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(3.03)</td>
</tr>
<tr>
<td></td>
<td>HvWinner</td>
<td>1.45</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(4.64)</td>
</tr>
<tr>
<td></td>
<td>HvWinner-LvLoser</td>
<td>0.70</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(2.71)</td>
</tr>
<tr>
<td>Mom</td>
<td>Winner-Loser</td>
<td>0.66</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(3.09)</td>
</tr>
</tbody>
</table>

Note: This table presents the average monthly percentage returns of the short, long and arbitrage portfolios of the momentum/volatility strategy (Mom/Vol). First, each month t, indices are ranked based on their six-month returns from month t-7 to t-1 month. The 25 per cent of indices with the largest past six-month returns are grouped in the Winner portfolio, while the 25% of indices with the smallest past six-month returns are grouped in the Loser portfolio. Within the Winner and Loser portfolios in each month t, indices are sorted based on their standard deviation of returns over the period from month t-7 to t-1. LvLoser represents the portfolio composed of the 50 per cent of indices in the Loser portfolio with the smallest standard deviations of returns and HvWinner represents the portfolio composed of the 50 per cent of indices in the Winner portfolio with the largest standard deviations of return. These portfolios are equally weighted. The arbitrage portfolio HvWinner–LvLoser is to be held for three, six, nine or 12 months. The monthly return for each holding period comes from employing Jegadeesh and Titman’s (1993) overlapping portfolio methodology. Winner–Loser refers to the corresponding pure momentum arbitrage portfolio. T-statistics are presented in parentheses.

**TABLE 3: Risk-adjusted Momentum/Volatility and Momentum profits**

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Panel A: Developed Markets</th>
<th>Panel B: Emerging Markets</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Annualised Raw Ret.</td>
<td>Adj R²</td>
</tr>
<tr>
<td></td>
<td>α_p</td>
<td>Adj R²</td>
</tr>
<tr>
<td>Mom/Vol</td>
<td>LvLoser</td>
<td>0.079</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(-2.430)</td>
</tr>
<tr>
<td></td>
<td>HvWinner</td>
<td>0.181</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(2.289)</td>
</tr>
<tr>
<td></td>
<td>HvWinner - LvLoser</td>
<td>0.103</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(3.508)</td>
</tr>
<tr>
<td>Mom</td>
<td>Winner - Loser</td>
<td>0.088</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(3.633)</td>
</tr>
</tbody>
</table>

Note: This table presents the two-factor regression results for the momentum/volatility and the momentum strategies with six month holding periods. LvLoser represents the portfolio composed of the 25 per cent of indices with the lowest past six-month returns and Winner represents the portfolio composed of the 25 per cent of indices with the highest past six-month returns. HvWinner represents the portfolio composed of the 50 per cent of indices in the Winner portfolio with the largest past standard deviations of returns and HvWinner represents the portfolio composed of the 50 per cent of indices in the Winner portfolio with the largest past standard deviations of returns. The two-factor regression model is:

\[
R_{p,t} - R_{f,t} = \alpha_p + \beta_{p,mkt}(R_{mkt,t} - R_{f,t}) + \beta_{p,vmg} V_{mg,t} + \epsilon_t
\]

where \(R_{mkt,t}\) is the market factor represented by the return on the MSCI World market portfolio. \(R_{f,t}\) is the one-month US Treasury Bill return, and \(V_{mg,t}\) is the value-growth factor represented by the return on the MSCI World Value Index minus the return on the MSCI World Growth Index. Annualised Raw Ret. is the annualised unadjusted return for the respective portfolio. The t-statistics presented in parentheses are corrected for heteroskedasticity using the White (1980) test.

Growth factor is the return on the MSCI World Value Index minus the return on the MSCI World Growth Index at time t. These indices were downloaded from Datastream. The coefficients \(\beta_{p,mkt}\) and \(\beta_{p,vmg}\) are the regression loadings on the two factors, while the intercept \(\alpha_p\) (or simply alpha) represents the risk-adjusted abnormal returns of the portfolios over the estimation period. If alpha is statistically significantly different from zero, then this is evidence of abnormal profits. The t-values corresponding to the regression coefficients are corrected for heteroskedasticity using the White (1980) test.
Table 3 presents the annualised regression alphas for the momentum/volatility portfolios with six-month holding periods, together with the associated t-statistics and adjusted R-squared values. The results for the corresponding pure momentum strategy’s Winner–Loser portfolio are also displayed. Table 3 also reports the annualised average raw return of each portfolio so that the impact of the risk adjustment can be assessed.

The developed markets results in Panel A indicate that the momentum/volatility strategy’s profitability survives the risk-adjustment process. The risk-adjusted return of the arbitrage portfolio (HvWinner – LvLoser) remains significant at 9.9 per cent per year (t-value 3.508) with only a fraction of the unadjusted 10.3 per cent profits explained by the model. As might be expected from the raw results for developed markets discussed in the previous section, the risk-adjusted profit of 9.9 per cent for the momentum/volatility strategy is only marginally larger than the pure momentum profit of 9.3 per cent. Panel A also shows that both the long and the short portfolios contribute to the overall profitability of the strategy, displaying significant risk-adjusted returns of 5.4 per cent per year (t-value 2.289) and -4.6 per cent per year (t-value -2.43), respectively.

The risk-adjusted momentum/volatility results in Panel B for the emerging markets are dramatic. The arbitrage portfolio’s large unadjusted profit of 17.4 per cent per year produces an alpha of 21.4 per cent (t-value 2.881). This alpha is much larger than the alpha of 12.7 per cent (t-value 2.052) generated by the pure momentum strategy. If we consider the component portfolios of the momentum/volatility strategy, we see that the short portfolio (LvLoser) has an insignificant alpha of –0.3 per cent (t-value –0.055). In contrast, the long portfolio (HvWinner) has a remarkably large alpha of 21.1 per cent (t-value 3.02). Since this alpha is almost the same as the momentum/volatility strategy’s alpha of 21.4 per cent, investors can effectively capture the momentum/volatility alpha with a long-only strategy of buying high-volatility recent winners.

In this paper we have linked momentum to risk by using past volatility to improve on the momentum strategy. Although the profits of the momentum/volatility strategy survive risk-adjustment by the two-factor model, the possibility remains that a risk-based explanation of momentum may eventually prove successful based on a different model. Cooper et al. (2004) show that average momentum profits are positive only following periods with positive market returns. This result suggests a possible role for risk in explaining momentum. In contrast, Griffin et al. (2003) show that business cycle risk cannot explain momentum.

While many attempts to explain the momentum anomaly have appeared in the literature, neither risk-based nor behavioural explanations seem convincing at this stage (Jegadeesh & Titman 2001). While space constraints preclude us from reporting detailed post-holding period results, we can summarise our findings as follows. Pure momentum strategy profits are reversed within five years, whereas momentum/volatility profits are not reversed within five years. These differing post-holding period results (if confirmed in other settings) will challenge a number of existing momentum explanations. Given that our momentum/volatility portfolios are components of pure momentum portfolios, perhaps momentum is a composite phenomenon requiring different explanations for different components.

Discussion and Conclusion

This study has examined whether momentum strategies applied to international indices can be improved by taking into account each index’s recent volatility. Our study answers this question in the affirmative. While the momentum/volatility strategy produces only small improvements over pure momentum in the developed markets case, the new strategy performs remarkably well when applied to emerging markets. For emerging markets, high-volatility recent winners outperform low-volatility recent losers on an average annualised basis by 17.4 per cent. In contrast, the long portfolio of the pure momentum strategy for emerging markets outperform the short portfolio by 9.1 per cent.

In addition, high-volatility winners earn an average annualised return of 28.3 per cent and an alpha of 21.1 per cent in emerging markets. While these anomalous results are of direct interest to practitioners, they also suggest opportunities for future research into whether stock-level and industry-level momentum strategies could be enhanced by taking past volatility into account.
Notes
1. A size factor is not needed in this context because the MSCI indices include only large liquid stocks.
2. This is the Ibbotson and Associates Inc. one-month T-bill rate which was downloaded from Kenneth French’s website: http://www.mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.

References
REGULATING COMPLEX FINANCIAL PRODUCTS: LESSONS FROM LEGAL INNOVATION INTERNATIONALLY

This paper examines the legal and policy implications of the implosion of the securitisation market internationally and argues that comprehensive reform cannot be left to the courts. The paper highlights the limitations of the current legal framework by evaluating the US settlement reached by Goldman Sachs following SEC proceedings against it. Reforms based on proceedings such as this divert attention from the key normative values of permissibility, responsibility and legitimacy — critical features of liberal democracy on which contemporary capitalism rests.

The unresolved policy problem is that professional and/or sophisticated investors trading as individual or institutional actors were aware of, but transacted around, the risks. In summary, the search for yield trumped reason. If defective disclosure was not the cause of both the myopia and the primary problems that arose in the sophisticated sector, a more granular ex ante articulation of risk is unlikely, in itself, to be effective. Is the regulatory response, therefore, misguided? Alternatively, is a more subtle, complex re-calibration of what constitutes duty of care in finance being played out, one which could have potentially far-reaching consequences for capital market practice and governance?

Satisfactory answers require an evaluation of how the reform agenda addresses a range of issues, not just objective efficiency (i.e. lower transaction costs). Three additional distinct but overlapping subjective normative criteria must be applied. First, permissibility (i.e. whether a particular product can be sold and if so to whom and on what basis); second, responsibility (i.e. who carries the risk if the investment sours and on what terms); and third, legitimacy (i.e. does the product serve a legitimate purpose and who should determine it).

These normative considerations, central to the functioning of liberal democracies, underpin regulatory debates in the United States as well as the United Kingdom and here in Australia. The disclosure debate masks, therefore, a much more profound ideological dispute. Definitive resolution will determine whether the reforms herald substantive change or mark yet another exercise in the triumph of the politics of symbolism. There are grounds for cautious optimism that reforms will move more in the direction of the former.
Unlike previous crises, which started or were contained within specific countries or discrete regulatory systems, the dislocation caused by the implosion of the securitisation markets revealed the spurious nature of the *rules v principles* bifurcation as the primary distinguishing feature of regulatory design. Both systems of oversight were incapable of embedding the ethical restraint required for effective market integrity (O’Brien 2010). In a somewhat mischievous and sentient intervention, Hector Sants (2009) has complained that it was impossible for principles-based regulation to work when those charged with informal authority to maintain the integrity of the system had no principles. This was not simply a particularly memorable aside. As with pregnancy, it is impossible to be semi-ethical. This, in turn, suggests the need for the dynamic integration of rules, principles and social norms within an interlocking responsive framework. To be effective, this must be capable of application across all levels within individual markets and across national boundaries. To do otherwise risks the kind of regulatory arbitrage that has done so much to loosen reputational restraints. The critical question is whether this can be done? Here the evidence of an initial repositioning within regulatory practice in the United States as well as the United Kingdom and here in Australia is encouraging — but by no means confirmed.

The limits of disclosure

The changing contours of global regulatory ambition have been sketched by Lord Turner, the Chairman of the soon-to-be-abandoned Financial Services Authority (FSA) in the United Kingdom. In his influential 2009 review of the banking sector in the United Kingdom, Lord Turner publicly questioned the social utility of financial engineering. Just as significantly, Turner (FSA 2009, p. 39) argued ‘the [global financial] crisis also raises important questions about the intellectual assumptions on which previous regulatory approaches have largely been built’. The Securities and Exchange Commission (2010b) has affirmed, implicitly, these flaws as part of its proposed rules to enhance the disclosure required for products offered to sophisticated investors. Now Australia too is questioning the efficacy of the regulatory architecture, through an exceptionally contested consultation process (Treasury 2010, pp. 8–10).

The Australian review has been prompted because complex financial products were systematically sold to mid-market participants (i.e. those that were deemed sophisticated or professional in legal terms but were, arguably, nothing of the sort). Crucially, those unable to manage risk included municipal authorities in metropolitan Sydney, rural New South Wales and Western Australia. In class action litigation now before the Australian Federal Court, the councils claim Lehman Brothers Australia (LBA) was guilty of deceptive, misleading and unconscionable conduct in the provision of financial advice. They also claim that the inclusion of complex risky financial products contravened management protocols to privilege conservative over aggressive portfolio selection. LBA has denied the claims. It argues that no duty of care was owed as the councils met the sophisticated investor criteria laid down in the *Corporations Act 2001*. LBA argues that the contractual wording of the individual agreements gave it considerable latitude. The matter is now before the Federal Court. It is not the place of the author to pre-determine the outcome. What is interesting, however, is the extent to which the defence used by LBA closely tracks that used in litigation in the United States, most notably in the case brought by the Securities and Exchange Commission against Goldman Sachs, which is detailed below.

Irrespective of the jurisdiction, therefore, the interlinked corporate, legal and broader political pressures highlight a single existential dispute. It is predicated on the potential incommensurability between the enabling basis of private law and the public law imperatives of securities regulation. Past reliance on bifurcation masked but did not resolve this core problem. The global financial crisis has made resolution a public policy imperative. I stress, therefore, that much greater emphasis needs to be placed on articulating and delineating more precisely where responsibility and accountability lies in financial product design. Unfortunately, legal action in the United States has delayed comprehensive resolution of this question, most notably in the Goldman Sachs case, the most notorious litigation yet seen in the securitisation crisis.

**Taking on the street**

When taking enforcement action, regulatory agencies need to balance the effect of conviction with the political
costs associated with bringing complex and uncertain cases to trial. Beyond the merits of an individual action, achieving a wider demonstration effect requires changing both the content and context of the underpinning regulatory system. First, the preparation of the case and its subsequent staging — including the critical initial presentation of the evidential base — needs to reconfigure media representations of what constitutes acceptable conduct. This reality applies irrespective of the legal strength of the material claim. Irrespective of the domain, trial strategies tend to focus on competing (if partially understood) narratives, one of which gains media traction. It is, therefore, essential to ‘own’ the media agenda. Second, the litigation needs to be capable of recalibrating — without credible dissension — the broader policy agenda.

The very fact of prosecution can endorse, justify and legitimise agency interpretation of legal and regulatory authority. To be successful, therefore, prosecutorial strategies need to facilitate the positive framing of policy issues around not only the regulator’s own interpretation of its appropriate purpose and accountability but also broader societal understandings, which are intermediated through media narratives. This coupling is essential to ensure that neither judicial failure nor premature settlement will translate into an incremental erosion of wider support for the legitimacy of the regulator’s operational imperatives.

These interlinked factors were all too evident in the litigation brought by the Securities and Exchange Commission against Goldman Sachs. Moreover, there was a striking similarity between the media management of this case and those prosecuted by former New York State Attorney General Eliot Spitzer over conflicts of interest in analyst research in the aftermath of the Enron and WorldCom accounting scandals (see Macey 2004; O’Brien 2005). For Spitzer, the veracity of the legal claim was always less important than the staging of the litigation and its impact on broader policy goals, as well as his own political self-interest. Spitzer gambled correctly that the sweeping powers afforded to the New York Attorney General through the New York Business Law of 1921 (sections 352–353), otherwise known as the ‘Martin Act’, shifted the risk calculus in favour of the state. The law gives the State Attorney General unparalleled investigative capacity to probe activities that could be detrimental to the well-being of the state. Until Spitzer’s innovative application, the law was rarely used to investigate financial services (although his strategy was replicated by his successor as both State Attorney General and Governor, Andrew Cuomo).

Given the dominance of New York City as a financial centre, Spitzer — and, indeed, Cuomo — was able to use the state law to highlight the manner in which Wall Street actually operated. Embarrassed at the time by Spitzer’s recurring efforts to set his own policies and by the political firestorm that accompanied revelations that Wall Street practices had not in fact changed in the intervening period (thus allowing Cuomo to enter into the enforcement arena), the SEC was determined to take a much more aggressive approach. Despite the risk that it could be accused of adventurism by taking the case against Goldman Sachs, the divided and wary federal commission opted to chance litigation failure (Goldfarb 2010).

The strategic calculation for both the SEC and Goldman Sachs lay in the reputational implications of proceeding to trial. For the SEC, the risk that a jury would find that Goldman Sachs was following accepted, albeit flawed, rules of the game needed to be balanced with rising public and political pressure to hold the banking sector to account. Along with other regulatory agencies, the SEC had been criticised by President Barack Obama (2009) for its prior failure to police Wall Street. Indeed, criticism of regulatory capture plays a central part in the narrative constructed by the Financial Crisis Inquiry Commission (2011). For Goldman Sachs, protesting innocence on technical grounds provided succour to those legislators pressing for enhanced financial oversight (e.g. Levin 2010a). Neither party to the case had an interest in proceeding to trial or to a lengthy appeal process. The litigation is best seen, therefore, as part of a calculated bargaining process. Despite the apparent success of the SEC in forcing a $550 million settlement, it is far from clear that the SEC emerged as the winner. It may well, in time, be seen to have won the hand but lost the game.

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backlash. Having lost the public relations advantage, the bank remained on the defensive. It failed to submit a substantive response (Goldman Sachs 2010a; 2010b; 2010c; Gallu 2010). Despite its protestations of innocence, proffering a legal defence that could change the media dynamic was problematic to say the least. The danger associated with an inability to control the agenda became acutely apparent as news leaked of a potential investigation into a second CDO transaction, disclosed at an exceptionally combative hearing of the Senate Permanent Committee on Investigations 11 days after the ABACUS suit was filed (Gallu and Harper 2010). The tone of the broader debate, which encapsulated the difficulties faced by the banking sector, was set by Senator Carl Levin’s opening statement. He claimed that Goldman Sachs had corrupted the industry and despoiled the Republic.

Investment banks such as Goldman Sachs helped feed the conveyor belt of toxic assets that nearly brought economic ruin. Goldman Sachs repeatedly put its own interests and profits ahead of the interests of its clients and our communities. Its misuse of exotic and complex financial structures helped spread toxic mortgages throughout the financial system. And when the system finally collapsed under the weight of those toxic mortgages, Goldman profited from the collapse (Levin 2010b).

Levin was incredulous at the public stance adopted by Goldman Sachs. For the bank ‘to go out and sell these securities to people and then bet against those same securities, it seems to me, is a fundamental conflict of interest and ... raises a real ethical issue’ (Levin 2010a). As a consequence, he advocated a more aggressive policing of the securitisation market than the Obama Administration had previously considered. Goldman Sachs attempted to steer the debate away from ethical considerations. Goldman Sachs (2010b) noted that the ‘SEC’s complaint accuses the firm of fraud because it didn’t disclose to one party of the transaction who was on the other side of that transaction’. This was a further example of a case that the bank claimed was ‘wrong in law and fact ... As normal business practice, market makers do not disclose the identities of a buyer to a seller and vice versa’ (Goldman Sachs 2010b).

Goldman placed responsibility for picking the referent stocks on the independent rating specialist, ACA, precisely because it ‘had the largest exposure to the transaction, investing $951 million ... [it] had an obligation and every incentive to select appropriate securities’ (Goldman Sachs 2010b). Therefore, according to Goldman Sachs, if ACA placed inappropriate referent securities in the offering, it had not only failed in its obligation, it had also acted irresponsibly on its own account. This transference of responsibility underpinned Goldman executives’ testimony to the congressional inquiry, which had so angered Senator Levin. Moreover, the argument by the Goldman Chief Executive Officer that the firm was merely facilitating ‘God’s work’ proved unhelpful (Arlidge 2009, p. 4). Subsequently, Goldman Sachs announced the creation of a Business Standards Committee. It announced that the results of its review would be made publicly available, a promise delivered the following year (Goldman Sachs 2011). The SEC commended both initiatives as sincere attempts by the firm to address the perceived ethical deficit (SEC 2010a). A more realistic assessment, however, is that Goldman Sachs concluded that neither the case nor its prior approach was remotely winnable in the court of public opinion.

Closing necessitated accepting that past practice had severely damaged the firm’s self-proclaimed reputation for integrity and probity. It was insufficient for the bank to merely state that practice had changed; it had to at least attempt to demonstrate that confidence was warranted. The creation of the Business Standards Committee is designed to provide a benchmark against which it is at least theoretically possible to judge ongoing if not past corporate behaviour (Goldman Sachs 2011, p. 62).

Despite the firm’s capitulation, however, the strength of the SEC’s legal case is questionable. The extraction of an admission from the bank that it was ‘mistaken’ in its management of the conflicts of interest further raises the risk that private litigation will benefit from what amounted to retrospective prosecution. Although there are circumstances in which retrospective prosecutions can and have been defended (e.g. Woozley 1968), the danger for regulators is that when the pendulum swings back, as it inevitably will, from enforcement to a focus on facilitating the growth of financial markets, accusations of regulatory adventurism will inevitably also return (see O’Brien 2007).

The very fact that the SEC has implicitly accepted the retrospective nature of its litigation against Goldman therefore poses long-term risks for the authority and legitimacy of the regulator.
If fealty to market integrity is to mean anything more than narrowly defined and easily transacted-around legal obligation, the reform agenda must address, comprehensively and directly, the ethical deficit at the heart of global finance. The central argument advanced here is that we cannot leave this to the court. It must and should be legislatively determined.

questions about the limits of the freedom to contract, which remains the underpinning rationale of corporate law in the United States and of securities market regulation throughout the common-law world. It is central to the Department of Treasury consultations here in Australia. The settlement of the Goldman Sachs case defers for the moment a definitive judicial ruling. How the courts and legislature eventually determine this issue will have profound consequences for the future global governance of investment banking activity.

It is in this regard that the SEC’s own presentation of revised rules for the governance of asset-backed securities creates future problems for the agency. The proposed rules, released while the Goldman Sachs litigation remained alive, undermined the legitimacy of its own case against the bank. They also ignited a broader normative debate about the purpose of the capital markets. In outlining the case for change, the SEC argued:

Investors have complained that the mechanisms for enforcing the representations and warranties in securitization transaction documents are weak, and thus are not confident that even strong representations and warranties provide them with adequate protection. In the private market we believe that, in many cases, investors did not have the information necessary to understand and properly analyse structured products, such as CDOs, that were sold in transactions in reliance on exemptions from registration (SEC 2010b, p. 12).

Such a failure to assess risk lies at the heart of the ABACUS transaction, and, of course, Goldman Sachs’ own defence. The ABACUS marketing materials, including the Flipbook — essentially a Powerpoint presentation — was exceptionally detailed. The contents prompted an influential New Yorker financial columnist to remark that they may well have said ‘Don’t trust us’ (Surowiecki 2010, p. 25). The ABACUS transaction provides a salutary lesson in how incompetence and greed guided investor decision-making. It also demonstrates an amoral imperative on the part of the former investment bank, which has now lost its independent status by submitting itself to federal oversight. These dual failures provide a justification for future reform, but not necessarily retrospective prosecution, a point implicitly conceded by the SEC. As the agency (SEC 2010b, p. 22) correctly argues:

The financial crisis has called into question the ability of our rules, as they relate to the private market for asset-backed securities, to ensure that investors had access to, and had sufficient time and incentives to adequately consider appropriate information regarding these securities. However, all our proposals, if adopted, would apply to new issuances of asset-backed securities. Therefore, the proposed rules, if adopted, would not impose new requirements on outstanding asset-backed securities.

These proposed rule changes also include the need to provide ‘basic material information concerning the structure of the securities thereon, the nature, performance and servicing of the assets supporting the securities, and any credit mechanism associated with the securities’ (SEC 2010b, p. 273). The rule changes are, however, of limited value to investors who fail to conduct their own due diligence. It is this concern about regulatory adventurism that underpinned the criticism that did so much to weaken prosecutorial authority in the lead-up to the boom.

Conclusion
It is, perhaps, unfortunate that it takes the threat of strengthened private and public enforcement action for influential banks to take seriously their responsibility for protecting market integrity. The sad reality, however, is that without such strengthened enforcement, combined with articulation of professional commitment to market integrity, meaningful change is unlikely to occur. If fealty to market integrity is to mean anything more than narrowly defined and easily transacted-around legal obligation, the reform agenda must address, comprehensively and directly, the ethical deficit at the heart of global finance. The central argument advanced here is that we cannot leave this to the court. It must and should be legislatively determined.■
Note
1. The financial support of the Australian Research Council is gratefully acknowledged ('The Future of Financial Regulation' (LP100100713) and 'The Limits of Disclosure' (LP100200573)).

References
O'Brien, Justin 2007, Redesigning financial regulation, the politics of enforcement, John Wiley & Sons Ltd, Chichester, West Sussex.
VOLUNTARY DISCLOSURE, TRUSTEE GOVERNANCE AND BACKGROUND IN AUSTRALIAN SUPERANNUATION FUNDS

Despite the significant role of superannuation funds in maintaining the sustainability of national retirement schemes, little is known about their governance structure. Our research indicates that very few Australian superannuation funds voluntarily disclose information about their main controlling body — the board of trustees. The current low level of disclosure by boards of trustees, including information about trustees, raises questions about the selection and review of trustees, and their accountability to fund members.

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Australian superannuation funds are controlled by trustees. The recent Super System Review commissioned by the Commonwealth Government pointed out that almost all issues in the superannuation system can be linked to trustee governance.1 Superannuation fund trustees have the duty of safeguarding members’ interests and mitigating investment managers’ and financial intermediaries’ self-fulfilling behaviours. Trustees’ expertise and knowledge are very important2 since it is impossible to require every superannuation fund member to have adequate financial literacy (Cooper 2010).

The current management structure of Australian superannuation funds involves multiple agents each holding various sets of information. Trustees and fund managers are the prominent agents in superannuation funds. Trustees provide oversight of members’ contributions and monitor the performance of internal and external agents. It is the duty of trustees to minimise the gap between the superannuation fund objectives and other agents’ objectives through clear mandates and communication policies, effective monitoring and reviews. We argue that trustees, not management, are the main holders of information about superannuation funds’ operations (except in terms of investment strategies and processes).

The governance of Australian superannuation funds rests upon the ‘prudent man rule’ according to which trustees are expected to exercise skill, duty of care, and diligence.3 This rule is less stringent than the ‘prudent business person’ rule applied to corporate directors by general law (Donald 2009) and allows more flexibility in the requirements and expectations of trustees’ skills and expertise. This does not necessarily imply that trustees have fewer skills and less expertise compared with corporate directors. However, the relevant policy requirements set by superannuation funds are currently deficient (Sy et al. 2008). In terms of disclosure, there is no clear requirement for the scope of information that is to be included in a superannuation fund’s annual report, nor is there any specific standard for these annual reports. Our survey of all of the 2009 industry superannuation funds annual reports revealed inconsistent disclosure practices with regard to the breadth and depth of information being published. A key indicator of a superannuation fund’s corporate governance is the transparency with which it is managed and the accountability of its agents.

While corporate governance literature provides an important framework for examining trustee governance, there are stark differences between corporate boards and trustee boards. Corporate directors are elected by shareholders to safeguard their interests and maximise the value of their share capital. Superannuation fund boards of trustees may be comprised of natural person4 trustees or companies that provide trustee services.5 The agency relationship is more complex with companies acting as trustees (Donald 2009).
In this paper, we refer to both natural person trustees and directors of trustee companies as trustees.

Corporate directors are driven by financial gains while trustees have a different set of complex goals and objectives. The type of funds trustees are associated with influences their objectives and decision-making framework. For example, industry superannuation funds are not-for-profit organisations, while retail funds focus on generating capital appreciation for the shareholders of the parent financial institutions and returns for their fund members. Hence, the success of a corporation is mainly measured in terms of financial gains and capital appreciation, while superannuation fund trustees may prioritise legal compliance alongside members’ interests (Gupta et al. 2007). The compensation package of corporate directors often includes shares and options that are designed to align their interests with those of the shareholders. Consistent with APRA’s study (Sy et al. 2008), our data shows that some trustees do not receive any fee for their services. Individuals’ motivation to undertake trustee positions may be very different from those of the corporate directors including, for example, a desire to develop their reputation and gain experience within the superannuation funds industry; it is within this context that we develop our hypotheses below.

**Literature and hypothesis development**

Disclosure can signal the values and development of a firm, product, or worker (Stiglitz 1979), and it is especially important in mitigating shirking behaviours in markets filled with dispersed ownership structures (Jensen and Meckling 1976). Management influences accounting information, information type and disclosure frequency based on their self-interest and other constraints (Watts and Zimmerman 1978; Leftwich et al. 1981). This underpins the hypothesis developed below.

Governance practices, including disclosure, are influenced by the regulatory environment in which a firm operates: the more stringent the regulation, the better the practices observed (Gillan 2006). Where there is no clear legal requirement and standard for disclosure, we argue that voluntary disclosure is dependent on the trustee structure and trustees’ background:

\[
\text{DIS} = \alpha + \beta_1 \text{NOM} + \beta_2 \text{EDU} + \beta_3 \text{IND} + \beta_4 \text{OUT} + \beta_5 \text{BS} + \beta_6 \text{DC} + \beta_7 \text{Size} + \varepsilon_i \tag{1}
\]
directors to a firm (Duchin et al. 2010). Independent non-executive directors are also associated with the provision of comprehensive information in mandatory financial disclosures (Chen and Jaggi 2000). The degree of board independence has a positive correlation with the board’s financial expertise, which suggests a complementary relationship between the two (Jeanjean and Stolowy 2009). Trustees who hold multiple outside directorships may benefit from a diversity of knowledge, information and resources, and are likely to be associated with better disclosure of information about trustee structure and composition since their networking essentially capitalises on their reputations.

**Board Size (BS):** Board size may be affected by fund size, fund growth rate and the merger activities of funds. We argue that as trustee board size grows, there will be an increased diversification of trustees’ expertise, a reduction in monitoring costs by trustees, and an improved balance of representation of members’ interests. This leads to improved disclosure policies and practices. In addition, larger boards may tap into better resources and information for the selection of asset consultants and fund managers.

**Control Variables: Trustee compensation and fund size**

Trustee compensation indicates if a trustee is providing services on the basis of competitive incentives. Based on the signalling hypothesis, this is an important control for identifying whether trustees provide disclosure in order to increase their future earnings and/or improve their future prospects in the labour market. The size and complexity of a firm may lead to variations in board structure due to the variances in monitoring costs and information complexity (Boone et al. 2007). Hence, firm size affects voluntary disclosure via its effects on governance variables (Kelton and Yang). Therefore, we argue that fund size may have an impact on disclosure.

**Methodology**

Members rely on product disclosure statements (PDS) and annual reports for information on their superannuation funds’ structure, operation and performance. We followed this path and collected governance variables by downloading all annual reports, PDS and trustee information published by industry superannuation funds on their websites. We then conducted searches using the internet search engine Google and two databases — *Business Who’s Who in Australia* and *Company 360* — to collect information about trustees’ educational background and outside directorships. We have only collected data for the financial year 2009 because the information on the governance of superannuation funds is limited and past years’ records are usually not maintained on websites. Since nomination of trustees for each type of superannuation funds is exogenous, we do not expect any endogeneity issue between trustee governance variables and disclosure level. We obtained industry superannuation funds financial data (trustee fee and fund size) from APRA for the period 2004–09. Due to the limited availability of data and our focus on trustees, we define fund voluntary disclosure through the level of disclosure about trustees’ profiles. Specifically, voluntary disclosure is a product of:

\[
\text{DIS Index} = \text{the percentage of trustees who disclose the field of their formal education} \times \text{the percentage of trustees who disclose the level of their completed education} \times \text{the percentage of trustees who disclose their outside directorship(s)}
\]

We measure trustee nomination by the type of nominator as reported by the superannuation funds. The types of nominator include independent party, member, employer, industry association bodies and professional trustee company. Trustees’ educational backgrounds are measured by the product of (1) educational completion level (i.e. diploma or school-leavers, undergraduate and postgraduate levels); (2) specialised fields (i.e. business and economics, arts and law, science, and others); and (3) whether a trustee has financial, governance or superannuation industry management expertise. For the third measure, we use trustees’ professional memberships (CPA, CA, FAICD, CFA, CFP, ASFA, Finsia and AIST) as a proxy of their expertise and to determine access to resources and information relevant to the superannuation funds industry.

Board size measures the total number of trustees on each board. We derived two proxies for board independence: (1) the percentage of independent trustees per board; and (2) a dummy variable that indicates whether there are any independent trustees on each board. Outside directorship is measured by the number of directorships external to the sample superannuation funds that a trustee holds. Trustee compensation is measured in terms of total trustee fee. Fund size is measured in terms of year-end fund value and membership base.

**Results**

**Current landscape**

We surveyed 529 trustees from all 66 industry superannuation funds. Our results are comparable to those of Gupta et al. (2007) and APRA’s survey (Sy et al. 2008). With a total of 1,319 trustees in the whole industry, according to APRA’s 2008 survey (Sy et al. 2008), our sample consists of approximately 40 per cent of the trustee population. Table 1 shows the descriptive statistics: one set for trustee level, and another set for fund level. Descriptive statistics at the trustee level in Table 1 provide an outlook of Australian industry superannuation fund trustees’ background, as well as their funds disclosure practices and committee structures.

An average board has nine trustees, which is consistent with past surveys (Gupta et al. 2007; Sy et al. 2008). The number of outside directorships held by trustees in the industry superannuation funds (2.96 per trustee in Table 2)
Overall, voluntary disclosure of trustee board committees is low. Approximately 5.1 per cent of trustees do not disclose their nominators, while over 70 per cent of them do not disclose their educational and professional background.

**TABLE 1: Descriptive statistics of variables at trustee and fund level**

<table>
<thead>
<tr>
<th>Panel A: Trustee Level</th>
<th>Mean</th>
<th>Maximum</th>
<th>Minimum</th>
<th>Std. Dev.</th>
<th>Observation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Association-Nominated (dummy)</td>
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<td>0</td>
<td>0.4989</td>
<td>502</td>
</tr>
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<td>502</td>
</tr>
<tr>
<td>EDU</td>
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<td>9.0000</td>
<td>0.0000</td>
<td>3.1316</td>
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</tr>
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<td>0</td>
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<td>157</td>
</tr>
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<td>0</td>
<td>0.5005</td>
<td>146</td>
</tr>
<tr>
<td>Artlaw (dummy)</td>
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<td>0</td>
<td>0.4599</td>
<td>146</td>
</tr>
<tr>
<td>IND (%)</td>
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<td>1.0000</td>
<td>0.0000</td>
<td>0.1571</td>
<td>503</td>
</tr>
<tr>
<td>IND Dummy</td>
<td>-</td>
<td>1</td>
<td>0</td>
<td>-</td>
<td>503</td>
</tr>
<tr>
<td>OUT</td>
<td>2.9624</td>
<td>16.0000</td>
<td>0.0000</td>
<td>2.5146</td>
<td>266</td>
</tr>
<tr>
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<td>17</td>
<td>4</td>
<td>3.1590</td>
<td>512</td>
</tr>
<tr>
<td>DIS</td>
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<td>1.0000</td>
<td>0.0000</td>
<td>0.3371</td>
<td>529</td>
</tr>
<tr>
<td>DF2009 ($’000)</td>
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<td>22483.00</td>
<td>0.00</td>
<td>3365.56</td>
<td>523</td>
</tr>
<tr>
<td>DF Average ($’000)</td>
<td>589.34</td>
<td>15430.00</td>
<td>0.00</td>
<td>2078.96</td>
<td>519</td>
</tr>
<tr>
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<td>17.0500</td>
<td>8.9980</td>
<td>1.6249</td>
<td>510</td>
</tr>
<tr>
<td>Log Avg Size</td>
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<td>16.7200</td>
<td>8.9267</td>
<td>1.5671</td>
<td>523</td>
</tr>
<tr>
<td>Member 2009</td>
<td>188359</td>
<td>1965511</td>
<td>675</td>
<td>383900</td>
<td>523</td>
</tr>
<tr>
<td>Member Avg 6 yrs</td>
<td>148298</td>
<td>1701759</td>
<td>709</td>
<td>283900</td>
<td>529</td>
</tr>
<tr>
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<td>-</td>
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<td>0</td>
<td>0.3248</td>
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<tr>
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<td>360</td>
</tr>
<tr>
<td>INV (dummy)</td>
<td>-</td>
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<td>0</td>
<td>0.4026</td>
<td>360</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel B: Fund Level</th>
<th>Mean</th>
<th>Maximum</th>
<th>Minimum</th>
<th>Std. Dev.</th>
<th>Observation</th>
</tr>
</thead>
<tbody>
<tr>
<td>IND (%)</td>
<td>0.0994</td>
<td>1.0000</td>
<td>0</td>
<td>0.1827</td>
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<tr>
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<td>0</td>
<td>0.5035</td>
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<td>OUT%</td>
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<td>0.0000</td>
<td>0.3429</td>
<td>66</td>
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<tr>
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<td>DF2009 ($’000)</td>
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<td>22483.00</td>
<td>0.0000</td>
<td>3592.5</td>
<td>65</td>
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<tr>
<td>DF Average ($’000)</td>
<td>632.17</td>
<td>15430.00</td>
<td>0.0000</td>
<td>2073.27</td>
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<tr>
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<td>1965511</td>
<td>675</td>
<td>416399</td>
<td>65</td>
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<tr>
<td>Member Avg 6 yrs</td>
<td>160733</td>
<td>1701759</td>
<td>709</td>
<td>293174</td>
<td>66</td>
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<td>0</td>
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<td>0</td>
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<td>-</td>
<td>1</td>
<td>0</td>
<td>0.4026</td>
<td>41</td>
</tr>
</tbody>
</table>

Association Nominated: 1 = nominated by unions/professional association, 0 otherwise. Member nominated: 1 = nominated by members, 0 otherwise. EDU is an index that measures completion level, qualification and expertise of a trustee. Undergraduate: 1 = completed undergraduate studies, 0 otherwise. Postgraduate: 1 = completed postgraduate studies, 0 otherwise. Business: 1 = completed business, economics, accounting and/or finance formal qualifications, 0 otherwise. Artlaw: 1 = completed art and/or law formal qualifications, 0 otherwise. IND Dummy: 1 = one or more independent trustees are present on the board. DIS is an index that measures the disclosure overall completion level, educational field and outside directorship per board. OUT measures the number of outside directorship a trustee holds and OUT% measures the percentage of trustees who have outside directorships. BS measures the total number of trustees per board. DF2009 and DF Average measure the total trustee fees for the single period 2009 and an average of 6 years trustee fees for the period 2004 – 2009 respectively. Log Size 2009, Log Avg Size, Member 2009 and Member Avg 6 yrs are proxies for fund size. Log Size 2009 and Log Avg Size show the total fund value for the single period 2009 and an average of 6 years fund value for the period 2004 – 2008 respectively. Member 2009 and Member Avg 6 yrs measure the total number of members for the single period 2009 and an average of 6 years number of members for the period 2004 – 2009 respectively. ARC, FIN and INV represent the presence of audit, risk and compliance committees, financial committee and investment committee. IND% represents the percentage of independent trustees on the trustee board.
is slightly lower than the overall industry average of 3.5 (Sy et al. 2008). In terms of board committee, only 14.6 per cent within our sample had disclosed audit, risk and compliance committees, 7 per cent had disclosed finance committees, and 80 per cent had disclosed investment committees. These results were much lower than those in the APRA survey, which found that 76 per cent of all funds had both independent audit and regular self-assessments for regulatory compliance review (Sy et al. 2008); this indicates a poor level of current disclosure practices concerning governance information. An average trustee received $1083.77 in fees in 2009, and $632.17 (on average) in the 2004–09 period. This is significantly lower than the average remuneration of $38,000 in the APRA survey; however, the survey also found that 54 per cent of trustees did not receive any remuneration for their service, or did not declare their fees (Sy et al. 2008).

Overall, voluntary disclosure of trustee board committees is low. Approximately 5.1 per cent of trustees do not disclose their nominators, while over 70 per cent of them do not disclose their educational and professional background. On the other hand, only about 5 per cent of trustees are sitting on the board of funds that do not disclose whether they have independent trustees.

Approximately 44 per cent of trustees in the sample are nominated by industry/professional associations/unions, while 40 per cent are nominated by members (Table 2). Only 8.51 per cent are nominated by trustees’ employers. This compares with 32 per cent of trustees within the industry who are employer-representatives and 20 per cent who are member-representatives (Sy et al. 2008). Nomination is highly transparent as only 5.1 per cent of trustee nomination is not disclosed. Based on disclosed information, almost 15 per cent of trustees have attained undergraduate qualifications; 10.21 per cent have a postgraduate education, and 4.54 per cent are diploma holders or school-leavers. This is significantly lower than the results in APRA’s survey (Sy et al. 2008) which indicated that 65 per cent of trustees reported having university degrees, while only 11 per cent reported not holding any formal qualifications.

Trustees in Science and other fields, including Education, Carpentry, Trade Services and Engineering are the group that has the highest levels of disclosure (13.42 per cent), followed by trustees in Arts & Law (7.56 per cent) and Business & Economics (5.48 per cent). In addition, 71.6 per cent of trustees did not disclose whether they have financial expertise, 9.83 per cent of trustees

### TABLE 2: The distribution of trustees’ backgrounds and nominators, trustee board independence and committee structure as disclosed by funds

<table>
<thead>
<tr>
<th>Variables</th>
<th>Number of observations (n=529) %</th>
<th>Variables</th>
<th>Number of observations (n=529) %</th>
</tr>
</thead>
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<tr>
<td><strong>Board Independence Dummy (IND)</strong></td>
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<td><strong>Trustee Nominator</strong></td>
<td></td>
</tr>
<tr>
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<td>27</td>
</tr>
<tr>
<td>No</td>
<td>246</td>
<td>Association</td>
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<tr>
<td>Yes</td>
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<td>Employer</td>
<td>45</td>
</tr>
<tr>
<td><strong>Committee Structure</strong></td>
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<td><strong>Audit, Risk and Compliance (ARC)</strong></td>
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<td>NA</td>
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</tr>
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<td>No</td>
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<td>Association</td>
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</tr>
<tr>
<td>Yes</td>
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<td>Employer</td>
<td>40</td>
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<tr>
<td><strong>Completion</strong></td>
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<td>Dipl. or school leavers</td>
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<td>Undergraduate</td>
<td>79</td>
</tr>
<tr>
<td>No</td>
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<td>Postgraduate</td>
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</tr>
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<td>Yes</td>
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<td>Qualification</td>
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<td><strong>Financial Committee (FIN)</strong></td>
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</tr>
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<td>Arts &amp; Law</td>
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<td>335</td>
<td>Bus. &amp; Econ.</td>
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<tr>
<td>No</td>
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<tr>
<td>Yes</td>
<td>287</td>
<td>Total</td>
<td>529</td>
</tr>
</tbody>
</table>

Note: NA – no information is disclosed, No – the variable measured is absent and Yes – the variable measured is present. This result is for all trustees in the sample.
disclosed that they have financial expertise, and 18.5 per cent disclosed that they do not have financial expertise. In comparison, Gupta et al. (2007) found that 40 per cent of their surveyed trustees have a background in finance, but only 14.5 per cent of the 131 respondents have formal investment qualifications. The differences between our findings and those of Gupta et al. (2007) and Sy et al. (2008) provide a strong indication of continued poor disclosure practices.

Approximately 60 per cent of the sample trustees were not associated with complete audit, risk and compliance (ARC) committees on their board. Only 8.13 per cent have disclosed complete ARC, while 32 per cent are associated with non-disclosed ARC committee structures. Only 4.73 per cent of trustees were associated with a financial committee; in contrast, 54.25 per cent were associated with an investment committee on their board.

Regression analysis
In this section, we discuss what drives trustees to disclose information about themselves and how their educational and professional backgrounds relate to trustee board committees. We use Model (1) to test our research question on voluntary disclosure with a different proxy of trustee’s background and fund size to check for robustness. Table 3 shows the OLS results for EDU and completion level models only.

H1 is weakly supported. We found member-nominated trustees have a negative effect on the disclosure of trustees’ information. However, the effect of nomination by association is not significant. This result is not robust in other models. The connection between individuals and their nominators based on implicit long-term network and evaluation may be a more significant factor in the nomination process than selection from an open market.

We found that the larger the fund (in terms of fund value and number of members), the higher the level of voluntary disclosure. This supports the argument that larger funds are more capable and resourced to cope with disclosure costs.

### Table 3: OLS (heteroskedastic-robust) results for the disclosure of trustee information

<table>
<thead>
<tr>
<th>Variables</th>
<th>Total Educational and Experience</th>
<th>Completion Level Only</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Constant</td>
<td>0.8780*</td>
<td>0.9154**</td>
</tr>
<tr>
<td>Association-</td>
<td>-0.0355</td>
<td>-0.0236</td>
</tr>
<tr>
<td>Member-nominated</td>
<td>-0.1489**</td>
<td>-0.1313*</td>
</tr>
<tr>
<td>Undergraduate</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Postgraduate</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>EDU</td>
<td>0.0144*</td>
<td>0.0146*</td>
</tr>
<tr>
<td>IND%</td>
<td>0.5433</td>
<td>0.5774*</td>
</tr>
<tr>
<td>OUT</td>
<td>0.0212*</td>
<td>0.0259*</td>
</tr>
<tr>
<td>BS</td>
<td>-0.0012</td>
<td>-0.0011</td>
</tr>
<tr>
<td>DC2009</td>
<td>-0.0000</td>
<td>-0.0000</td>
</tr>
<tr>
<td>DC Average</td>
<td>-</td>
<td>-0.0000</td>
</tr>
<tr>
<td>Log Size 2009</td>
<td>0.0030</td>
<td>-</td>
</tr>
<tr>
<td>Log Avg Size</td>
<td>-</td>
<td>-0.0074</td>
</tr>
<tr>
<td>Member 2009</td>
<td>-</td>
<td>0.0000</td>
</tr>
<tr>
<td>Member Avg 6 yrs</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>F-value</td>
<td>4.07</td>
<td>4.16</td>
</tr>
<tr>
<td>Adj R-squared</td>
<td>0.2408</td>
<td>0.2507</td>
</tr>
<tr>
<td>P</td>
<td>0.0008</td>
<td>0.0007</td>
</tr>
<tr>
<td>N</td>
<td>61</td>
<td>60</td>
</tr>
</tbody>
</table>

* significant at 10% level, † significant at 5% level, ** significant at 1% level.
based on competitive professional profiles. Board size is negatively related to voluntary disclosure in the completion-level model.

H2 is supported by our results where a higher level of educational background has a positive relationship with voluntary disclosure when EDU index and formal qualification are used. Buseco and Artlaw both contribute positive effects to disclosure (results not reported in table). However, completion level models are not significant. This is in line with the signalling argument and consistent with the results for board independence. In contrast, IND per cent is found to be significant in all models, implying that the balance of control between independent trustees and other trustees on a board relies on the number of independent trustees relative to the size of the board. The coefficients for IND percentage in all models are the strongest with a positive impact in all models. This shows that the higher the number of independent trustees, the stronger their voices and influence on other trustees and board matters. The number of outside directorships (OUT) also has a significant but lesser positive impact on voluntary disclosure. The results support our hypothesis that board independence is positively related to voluntary disclosure, based on the notion that part of trustees’ future earnings growth is dependent on their current development and promotion of their reputational properties. In addition, independent trustees and trustees who have multiple outside directorships have a strong positive effect on levels of voluntary disclosure. This is due to their higher need for the promotion and development of their reputational properties with anticipation for future personal earnings growth. Our empirical results show strong inter-relationships between these characteristics and confirm the significance of the make-up of trustees’ boards for standards of funds governance. These unique results provide important insights for policy makers, regulators and practitioners in the regulation of the industry, and the enforcement of trustee accountability. Another important next step will be to test the impact of trustee governance on fund returns and risk.

Despite the limitations in the availability of information and the impact this had on the research methodologies we could employ, this study provides an important, innovative view of trustee governance that establishes new directions for the field. Further research in this area will enhance the understanding of trustee governance and its impact on fund returns and risk management.

Acknowledgement:
We would like to thank Scott Donald for his helpful comments and suggestions. We would also like to thank the Australian Centre for Financial Studies for providing financial support.
Notes

1. The Review recommends a Code of Trustee Governance, suggesting that effective trustee practices and structures will lead to enhanced performance in the industry (Cooper 2010).


4. There are currently only five large funds with natural person trustees (Cooper 2010), hence we do not differentiate the types of trustees in our examination.

5. See Section 2 in Chapter 2 of Part 2 in (Cooper 2010)

6. We also use two other proxies as the EDU index greatly reduces our sample size: (2) completion level (undergraduate and postgraduate dummy variables); and (3) formal qualification (buseco and artlaw dummy variables).

7. PS146 as a proxy was dropped due to significant low disclosure.

8. The CEO–Chairman duality variable is dropped because no incidence is present in the sample, reflecting that the two positions are held by separate individuals in all 66 industry superannuation funds.

9. This study comprised of 48 of the top 200 funds in 2004–05, where half of the sample were corporate funds.

10. This survey included 187 superannuation funds representing the whole population in 2006.

11. The IND dummy is found to be a non-significant factor; therefore, results were not included in the table.

References


Donald, M. S. 2009, ‘What contribution does trust law make to the regulatory scheme shaping superannuation in Australia?’, Australian Prudential Regulation Authority.


Sy, W., Inman, C., Esho, N. and Sane, R. 2008, ‘Superannuation fund governance; trustee policies and practices’, Australian Prudential Regulation Authority, Melbourne.

‘I CAN’T GET NO SATISFACTION’
... OR CAN I?: A STUDY OF SATISFACTION WITH FINANCIAL PLANNING AND CLIENT WELL-BEING

As industry and policy makers strive to professionalise financial planning and enhance the quality of advice, it is important to understand how financial advice contributes to consumer well-being. The findings of this study indicate financial planning advice has positive effects, with clients feeling more in control of their finances, more prepared for contingencies and putting more effort into their financial affairs. The results also indicate that respondent clients’ appraisals of their financial situation have a bearing on a number of other areas of their life and well-being.

This paper reports findings from an ongoing collaborative research project with the Financial Services Council (FSC), which contributed funding and facilitated the survey of financial planners’ clients through FSC member organisations. The article draws on the report to the FSC that was prepared by the QUT researchers, reporting findings on the initial exploratory stage of the project.¹

The lyric in the title of this paper has become a catchcry for consumers dissatisfied with a range of financial services and products, and, as recent Federal Government inquiries have revealed, there is some truth to the claim. But as financial planning undergoes a series of reforms, including increased professionalism (FPA 2009) and improved quality of advice (Australian Government 2011), there are good reasons to explore the conditions under which clients report satisfaction with their financial planners; not least because the provision of effective financial planning and advice, delivered in accordance with, or transcending, the rules and norms of industry best-practice has the potential to benefit clients, not just financially, but across a number of life domains.

In this paper, we report findings from an exploratory study investigating whether financial planning and advice contribute to client well-being, beyond effects on financial well-being. While anecdotal evidence supports psychological benefits such as a sense of security, little research has explored these links in any systematic or theoretically driven way. However, theory and research from cognate disciplines, such as psychology, indicate clear links between planning, goal setting and well-being that are likely to arise in the financial planning domain.

Surveyed clients were asked to indicate their satisfaction with their financial advisers, the planning process and the advice they received. Clients responded to items designed to reflect key areas for financial planners in the shift towards increased professionalism, improved disclosure and greater client focus (e.g. FPA 2009). Clients also reflected on their financial situations before and after seeing their advisers, and considered the impact of their financial situations on a number of life areas including family relationships, mental health and well-being, and overall life satisfaction.
Links between financial planning and well-being

Three aspects of financial planning can be noted with respect to consumer well-being: goal setting and attainment, planning and mastery, and appraisal of financial resources.

Goal setting and attainment

Lifestyle and financial goal setting are central to the six-step process of financial planning advocated by the industry worldwide.\(^2\) Goals are central to psychological well-being because they provide purpose to life and contribute to the process by which people come to view their lives as meaningful and worthwhile (Emmons 2003). However, not all goals are important or impart benefits to well-being. The setting of goals that are connected to individuals’ values and motivations, and are functional (e.g. saving for education), rather than materialistic (e.g. to own many expensive items), are more likely to meet core psychological needs and contribute to life betterment (MacLeod et al. 2008).

The attainment of goals as well as the sense of progress towards goals is also a source of life satisfaction. This is partly due to the reduction in the discrepancy between present and preferred states (Weise 2007) and partly because the anticipation of positive future outcomes contributes to a sense of life mastery and elicits positive emotions and mood states (Sheldon et al. 2002). In the financial planning context, clients who experience progress towards the attainment of their financial and lifestyle goals are likely to experience positive psychological benefits.

Planning and mastery

An essential element of psychological well-being is engagement in life tasks and roles. Having meaningful goals and the plans to achieve those goals enable individuals to experience higher levels of life engagement (MacLeod et al. 2008). Planning can be considered a life management strategy that enables individuals to control and structure their lives (Prenda & Lachman 2001). This sense of life mastery is linked to better psychosocial adjustment and mental health across a range of psychological measures (e.g. reduced depression, anxiety) and greater life satisfaction and well-being (Nezlek 2001; Ryff & Singer 2008).

Appraisal of financial resources

Research shows that financial satisfaction is higher when there is minimal discrepancy between material desires and the ability to afford them (Solberg et al. 2002). However, increasing one’s wealth is not necessarily the key to satisfaction, particularly when financial ambitions are unrealistic. Holding realistic financial aspirations and positive appraisals of one’s financial resources are linked to financial and life satisfaction (Martin & Westerhof 2003), and may be more important to well-being than objective wealth measures. Advisers who assist clients to better align their aspirations and resources, for example, may be more likely to encourage higher levels of financial and life satisfaction. Research suggests that improving financial satisfaction is linked to an increased sense of well-being and life satisfaction, partly because financial satisfaction is one of the underlying domains (including health and social domains) of overall life satisfaction (Easterlin 2006).

Financial planning, then, may be beneficial as a means of engaging individuals in important and meaningful life tasks that contribute to well-being. The act of seeking out a financial adviser (as a planning step in itself), the establishment of financial and lifestyle goals, and the plans to achieve those goals, all contribute to individuals’ sense of control over their financial and life situations. Financial planning that emphasises clients’ functional goals and personal values is more likely to be associated with client well-being, while clients who perceive that they are actively engaged with their advisers in the planning process are likely to feel more satisfied with both their finances and their lives.

In contrast to views of well-being as conceptually synonymous with happiness, we prefer a broader conceptualisation which encompasses life satisfaction and psychological benefit. At the personal finance level, financial security provides opportunities for the
achievement of things of personal value and the support of preferred lifestyles. Our research framework recognises that consumer well-being is likely driven by both process (e.g. achieving a sense of life mastery and autonomy through effective financial planning) and outcomes (e.g. feeling satisfied with financial planning advice outcomes).

Survey of financial advisers’ clients

Clients of eight financial advisers across two organisations providing financial planning advice were surveyed in mid-2010, with 172 usable (anonymous) responses received. Two-thirds of respondents had been clients of the financial advisers for more than a year (existing clients) while the remaining one-third had consulted with their adviser for the first time within the prior year (new clients).

The demographic profile of the sample is such that most respondents (84 per cent) are in the pre-retirement and retirement phases of their lives (50–69 years old), own their own home (71 per cent), hold most of their investment assets in superannuation, and have little debt.

The sample comprises 61 per cent males (39 per cent females) with similar age distributions for each gender. Just over half (56 per cent) of the clients have university level education, holding a Bachelor’s degree or higher; 17 per cent hold a trade or TAFE qualification. The current work status of respondents is predominantly those working full-time (42 per cent) on salaries and those who were retired (40 per cent). More existing clients (49 per cent) are retired than new clients (20 per cent), with the largest proportion (52 per cent) of new clients aged 50 to 59 years and the largest proportion (51 per cent) of existing clients aged 60 to 69 years. The majority of clients (75 per cent) live with a partner. More new clients (36 per cent) have children living at home than existing clients (17 per cent).

The majority of surveyed clients (85 per cent existing, 74 per cent new) reported a personal annual income of less than $100,000 per annum; 51 per cent of existing clients and 25 per cent of new clients reported a personal income of less than $50,000. When total household income is considered, the most frequent range is $50,000 to $99,000; 56 per cent indicated an annual household income between $50,000 and $149,999, while 27 per cent have less than $50,000.

Most surveyed clients hold most of their investment assets in superannuation. Clients’ superannuation balances range from less than $25,000 to over $1 million, with 36 per cent of clients having $500,000 or more in superannuation, 33 per cent in the $250,000 to $499,999 range and 29 per cent less than $250,000. Outside superannuation and home ownership, respondents’ most commonly held assets are shares (53 per cent), followed

![Figure 1: Level of client agreement with financial planner characteristics](image-url)
by investment properties (38 per cent), life policies (31 per cent), and managed funds (25 per cent).

In relation to frequency of contact with their financial planner, 29 per cent of clients reported seeing their planner twice a year or more, for 37 per cent it is once a year and for 34 per cent it is once every few years. Nearly half of surveyed clients (47 per cent) indicated they receive updates more than twice a year, for 35 per cent it is once or twice a year, and 17 per cent receive an update only every few years.

**Satisfaction with financial planners**
Overall, 77 per cent of surveyed clients indicated they are satisfied with their financial planners, 8 per cent are dissatisfied and 15 per cent are neutral. Figure 1 presents frequencies of clients’ responses on various aspects of financial planner characteristics, and shows that a high proportion of clients view their financial planners in a positive light. They agree that planners have good interpersonal skills, are knowledgeable and up to date, and professional in their approach.

**Satisfaction with the financial planning process**
A high proportion (72 per cent) of surveyed clients also indicated they are satisfied with the planning process, 12 per cent are dissatisfied and 16 per cent are neutral. Satisfied clients generally felt listened to, actively involved in the process, and helped by their planners to clarify goals and priorities (Figure 2). They viewed planners as providing a professional service and providing and obtaining information for good financial decisions. Around 45 per cent of clients agreed that the planner took control of planning their financial future while 30 per cent disagreed with this statement. Possibly, clients who saw themselves as controlling their own futures were more likely to disagree with this statement. Just over 10 per cent of clients disagreed that they received adequate information to make good decisions, help to clarify goals, and a comprehensive review of their situation.

**Satisfaction with financial advice and products**
Similar to the levels of overall satisfaction with their financial planner, a large proportion (77 per cent) of surveyed clients are satisfied with the strategies and products provided by their planner, 7 per cent are dissatisfied and 16 per cent are neutral. Figure 3 shows that the majority of clients (74 per cent and above) agree that their financial planner informs them of conflicts of interest, required disclosures and fees. A majority also feel that the advice is appropriate to their circumstances and addresses their financial goals. Only a small proportion (10 per cent) of clients feel that the advice does not explain how strategies and products address their financial needs and goals.

While around three-quarters of the respondents indicated satisfaction with the financial planner, the financial planning process and the financial advice and products, a smaller proportion indicated satisfaction with fees (58 per cent), with 28 per cent dissatisfied and 14 per cent neutral.

---

**Figure 2: Level of client agreement with financial planning process**

<table>
<thead>
<tr>
<th>Item</th>
<th>Disagree</th>
<th>Neither agree nor disagree</th>
<th>Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provides all the information I require to make good financial decisions.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provides a professional service.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Takes control of planning my financial future for me.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Clearly understands my financial needs and concerns.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Includes me in the planning process.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Listens to my ideas and concerns.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Helps me to clarify my financial goals and lifestyle priorities.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Comprehensively reviews my financial situation.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Actively involves me in planning for my financial future.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Clearly understands my financial goals.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Obtains from me all the information needed to address my financial goals &amp; concerns.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Demonstrates a good understanding of my current financial situation.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%
Features with which clients are most and least satisfied

Surveyed clients were asked to provide comments on aspects of their financial planner and the planning process with which they were most and least satisfied. About three-quarters of clients offered positive comments about their planners (71 per cent) and the process (77 per cent), whereas only 27 per cent commented on areas of least satisfaction with the planner, and 51 per cent on least satisfaction with the process.

In commenting on areas of most satisfaction, clients most frequently mentioned quality of advice, knowledge and expertise, professional qualities of the planner, supportive decision making, and engaging and personalised planning processes. Representative comments include:

‘His honesty, experience and wealth of knowledge.’
‘Keeps up to date with all changes, taxation/super, pension fund, and advises accordingly. His professional knowledge and company resources.’
‘The personal attention to detail plus personal contact and interest.’
‘He listens to me to what I have to say about my financial situation.’
‘He put up options by using applied decision making and using “what if situations” to help me decide what options I was going to take.’
‘That the adviser usually confirms that I’m making good decisions.’
‘A genuine endeavour to help and reassure us about the future and to feel comfortable about our old age.’

Comments about areas of least satisfaction related to insufficient detail and personalisation of the advice provided, service difficulties such as reduced access and time, and poorer client-adviser relationships in terms of communication, client understanding and reassurance. Some of the comments made by clients are:

‘Insufficient data — detail of what the different choices would produce.’
‘Still didn’t know if I would have enough to retire next year.’
‘Feeling that I am only a 1/2 hour interview in a busy day. Feeling that my account was only looked at prior to that interview.’
‘Little interaction on part of planner in between formal consultations.’
‘I am yet to develop a personal link with him.’
‘Being fairly financial illiterate a follow up phone call or brief analysis to make sure I did everything right (filled in the right forms etc.) would have been good.’
‘Felt like we were just another client in a long list. No specific interest shown in our financial position — poor follow up.’

Financial situations before and after seeing adviser

Surveyed clients were asked to provide ratings on a number of dimensions to indicate perceptions of their current financial situation, and to also give ratings of what they perceived their financial situation was before consulting with their current financial planner. As shown...
in Figure 4, comparisons of clients’ views of their current financial situations with their views of their prior situations reveal statistically significant improvements on seven of the eight dimensions. Clients feel more in control of their finances, have lower levels of stress, are more comfortable with their situations, are more prepared for contingencies, and put more effort into their finances than before seeing their financial adviser. They judge their current financial situations as more positive and more satisfying than their prior situations. While clients also indicated more frequent worrying before seeing their current planner, this difference is not statistically significant.

**Well-being before and after seeing planner**

Clients were also asked to indicate the effect of their financial situations (before and after seeing their planner) on eight life areas (mental health and well-being, family activities, family relationships, social activities, social relationships, work activities/ performance, work relationships, physical health and well-being).

New and existing clients were found to differ in their reports of the effects of their financial situation on their lifestyle and well-being, particularly when they were asked to consider their prior situation. For seven of the eight areas, new clients’ effect ratings were significantly higher for their current financial situation than their prior situations (t-tests, \(p<0.05\)). Figure 5 displays the percentage of new clients indicating positive, neutral and negative effects before and after seeing their planner. For example, 28 per cent of new clients thought their prior financial situation had a positive effect on their mental health and well-being, 37 per cent thought it had no effect, and 35 per cent thought it had a negative effect. After seeing their current financial planner, 44 per cent thought that their current financial situation has a positive effect, 26 per cent believed it has no effect, and 30 per cent believed it has a negative effect. While reports of negative effects declined in a number of areas, changes in reported effects predominantly relate to increases in positive effects and decreases in no effects.

As for new clients, a higher percentage of existing clients thought positive effects were attributable to their current situation than to their prior situation. However, differences in effect ratings (current vs prior) were only significant for three of the eight life areas (see Figure 6): family activities (43 per cent current, 35 per cent prior), social relationships (40 per cent current, 30 per cent prior) and family relationships (30 per cent current, 25 per cent prior).
implemented all of the strategies recommended by their financial planner, only 51 per cent of new clients had done so, suggesting that the financial situations of a number of new clients were still in a transition phase.

Contribution of financial planning to life satisfaction
While previous research indicates that life satisfaction is influenced by life circumstances and satisfaction in a number of domains (including financial), an unexplored issue is the extent to which aspects of the financial planning experience also contribute to life satisfaction.

For new clients it is possible that the recency of both their prior financial situation and their engagement in the financial planning process mean that the comparisons they made were more salient for them than for existing clients. For new clients, there appears to be a more immediate and marked effect of changes in financial situation on their perceptions of lifestyle and their well-being.

It is important to note that a number of new and existing clients report ongoing negative effects, suggesting these clients may be experiencing ongoing financial strain. In addition, while 80 per cent of existing clients had implemented all of the strategies recommended by their financial planner, only 51 per cent of new clients had done so, suggesting that the financial situations of a number of new clients were still in a transition phase.

Contribution of financial planning to life satisfaction
While previous research indicates that life satisfaction is influenced by life circumstances and satisfaction in a number of domains (including financial), an unexplored issue is the extent to which aspects of the financial planning experience also contribute to life satisfaction.
Using a life satisfaction score (measured using the 
*Satisfaction with Life Scale*, Diener et al. 1985), a 
hierarchical regression model was employed to test for 
associations with demographic variables reflecting clients’ 
life circumstances; these are gender (male/female), 
education (university/other), retirement status (retired/ 
other), empty nester (yes/no), and household income 
(less than $49,999, between $50,000 and $99,999, 
over $100,000). Financial appraisal variables (overall 
judgement of and satisfaction with financial situation) 
entered the model next, followed by overall satisfaction 
ratings of the financial planning process, the financial 
planner, financial products and strategies, and fees.

Our overall findings support the notion that the process of financial planning is 
potentially supportive of individuals’ well-being at a number of levels, not just 
the financial, and that this occurs when clients feel engaged with planners who 
are professional and client-focused.

Using a life satisfaction score (measured using the 
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associations with demographic variables reflecting clients’ 
life circumstances; these are gender (male/female), 
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entered the model next, followed by overall satisfaction 
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Our overall findings support the notion that the process of financial planning is 
potentially supportive of individuals’ well-being at a number of levels, not just 
the financial, and that this occurs when clients feel engaged with planners who 
are professional and client-focused.
engagement and well-being. There are also practical and psychological benefits to clients as a consequence of improvements in their financial situations after seeing a planner. Our overall findings support the notion that the process of financial planning is potentially supportive of individuals’ well-being at a number of levels, not just the financial, and that this occurs when clients feel engaged with planners who are professional and client-focused.

As with any exploratory study, there are limitations. The sample used in this study is confined to pre- and post-retirement clients of only eight planners across two organisations. The results are, therefore, limited in their generalisability. Broader client and adviser samples are required to further test associations between clients’ experiences of financial planning and their well-being at various life stages. The lack of baseline data (before seeing a financial planner) and measurement over time also prevents a full assessment of time-based changes and their effects on well-being. It is worth noting that the majority of clients in the study were satisfied with their planners. Clients who were dissatisfied with their advisers and experienced deterioration in their financial and life situations are likely to have discontinued their relationship with their planners. These clients would not have been ‘active’ clients and therefore unavailable to participate in the study. Future research will explore the associations between the features and outcomes of the financial planning process and client well-being for both satisfied and dissatisfied clients.

The current trend in financial planner training in Australia and elsewhere is towards professionalisation and the use of interdisciplinary knowledge bases to inform practice. We suggest that further research attention be directed to the financial planning process itself, and that a stronger research base is required not only for informing the professional practice of financial planners but also for a more complete understanding of the benefits of financial planning at the individual and family levels. Such knowledge is likely to have marked flow-on effects for economies and societies.

Notes
1. This project has been extended to a larger, longitudinal study of links between financial advice and well-being, with Australian Research Council Linkage grant funding awarded in May 2011 for QUT to conduct the research in partnership with the FSC.
2. See Financial Planning Standards Board at http://www.fpsb.org/

References
Emmons, R. A. 2003, ‘Personal goals, life meaning, and virtue: wellsprings of a positive life’ in C. L. M. Keyes and J. Haidt (eds), Flourishing: positive psychology and the life well-lived, American Psychological Association, Washington, DC.
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Australian Parliament

Complete Australian Hansard online

In May 2011 on the 110th anniversary of the first sitting of the Parliament of Australia, the complete Hansard of the Australian Parliament was made available online. The digitisation of Hansard from 1901 was undertaken by the Parliamentary Library to provide access to the record of the Parliament, which is vital for community awareness and engagement with the Parliament.

As part of the digitisation project, PDFs were delivered in mid-2010 and the eXtensible Markup Language (XML) versions are being made available in 2011.

Consumer finance

MoneySmart via mobile phone apps
www.MoneySmart.gov.au under Tools and resources

Five new MoneySmart mobile phone apps, which can be downloaded for free onto iPhone or Android handsets, have been developed by the Australian Securities and Investments Commission (ASIC) as part of the new MoneySmart.gov.au website. They offer calculators for savings, loan repayments, mortgage repayments, superannuation and the real cost of interest-free deals. These apps complement a range of online tools for a variety of other purposes.

New international mortgage trends report
www.genworth.com.au under News

In June 2011, Genworth Financial, a major international lenders mortgage insurer, released the inaugural Genworth International Mortgage Trends Report, which outlines the results of a survey of borrower sentiment and mortgage market trends in eight countries across four continents. The report is based on a survey of more than 9,000 current and aspiring homebuyers from Australia, Canada, India, Ireland, Italy, Mexico, the United Kingdom and the United States, comparing borrower attitudes in those countries towards the economy, their personal finances and the mortgage market.

Financial literacy summary youth report published
www.missionaustralia.org.au under Document downloads

The MoneyMinded Summary Report: A case study of Mission Australia’s financial literacy program for youth at-risk was released in March 2011. The report was written by Roslyn Russell, Damien Bailey and Lauren Wall of RMIT University and Robert Brooks of Monash University, and published by ANZ Bank. This was the sixth annual evaluation of the MoneyMinded Program. By the end of 2010, MoneyMinded had reached nearly 125,000 people since tracking began in 2005. This milestone exceeds ANZ’s target set in 2005 and establishes MoneyMinded as the most widely used resource for helping to build financial capability in Australia.

Group Buying Platform OfferMe unveils Virtual Shopping Centre
www.offerme.com.au

Australian-based Group Buying Platform, OfferMe, launched their virtual shopping centre platform MeStore in May 2011. Offerme.com.au, one of Australia’s earliest group buying sites, was launched in 2008. It specialises in delivering a broad range of merchandise including electronics, computers, bike accessories, musical instruments, sporting goods, computer accessories, toys, homewares and event tickets.

The business model enables individual businesses or sellers to offer consumers big discount group buy deals via the OfferMe site through their own personalised online shop front in the OfferMe virtual shopping centre. The MeStore services features full e-commerce and ‘buy now’ functionality and enables retailers to promote and sell the full range of their goods and services for as little as $30 per month.

Financial markets

ASIC research on the impacts of misconduct
www.asic.gov.au under

In May 2011, the Australian Securities and Investments Commission (ASIC) published research on the social impact of misconduct in the financial services industry. It gives examples of misconduct leading to financial losses, such as inappropriate advice, fraud, defective disclosure and misleading or deceptive conduct.
ASIC’s Consumer Advisory Panel (CAP) commissioned
Susan Bell Research to conduct a study into the social
impacts of investors suffering losses due to licensee
misconduct in circumstances where the licensee is
unable to provide full compensation. This research
aims to provide a better understanding of the personal
consequences of investors not being fully compensated
and to help inform submissions to the Government’s
review into whether a statutory compensation scheme
should be introduced in Australia.

2010 Australian share ownership study released
www.asx.com.au under Announcements

According to the latest Australian Share Ownership Study
released in May by the Australian Securities Exchange
(ASX), approximately 7.3 million people or 43 per cent
of the adult Australian population own shares, either
directly (via shares or other listed investments) or
indirectly (via unlisted managed funds), and the total
ownership level has increased from 41 per cent when the
study was last conducted in 2008. The study found that
eight out of every 10 investors who own shares directly
felt it was a good time to buy or to hold shares.

New EDHEC-Risk Institute research on inflation-linked
bonds
www.edhec-risk.com under Publications

In a climate of increasing inflation uncertainty, EDHEC-
Risk Institute has released a new study analysing optimal
corporate debt management policies, Optimal design
of corporate market debt programmes in the presence
of interest-rate and inflation risks. The study, which was
produced as part of research in the area of inflation-linked
corporate bonds, in partnership with Rothschild & Cie,
examines the optimal liability structure when the issuer
faces such instruments as fixed-rate debt, floating-rate
debt and inflation-linked debt.

IOSCO finalises principles to address dark liquidity
www.iosco.org under Library

In May 2011, the Technical Committee of the International
Organization of Securities Commissions (IOSCO)
published a final report, Principles on Dark Liquidity,
containing principles to assist securities markets
authorities in dealing with issues concerning dark
liquidity. The principles are designed to guide regulators,
institutions and general users of dark liquidity with respect
to: transparency to market participants and issuers;
priority of transparent orders; reporting to regulators;
information available to market participants about dark
pools and dark orders; and regulation of the development
of dark pools and dark orders. IOSCO intends to review
these principles in light of current market and regulatory
developments.

Environment

New carbon offset website launched
www.yonderr.com.au

In July 2011, Australia’s largest provider of dedicated
carbon sink plantings, CO2 Australia, a wholly owned
subsidiary of publicly listed CO2 Group Limited (CO2
Group), announced the launch of its unique website,
called Yonderr. The website, where people and businesses
can purchase carbon offset packages specifically tailored
to their lifestyle or business, is intended to offer people
a simple way to offset individual, family or business
carbon emissions.

Trade and development

New financial services gateway website
www.austrade.gov.au under Financial services

Austrade, the Australian Trade Commission, recently
launched an online portal aimed at helping international
investors navigate Australia’s financial sector while
enhancing the country’s appeal as a regional investment
hub. This initiative should promote understanding of
Australia’s regulatory environment and act as a central
destination to guide potential investors to information
regarding our banking, superannuation, insurance and
funds management sectors.

IMD World Competitiveness Yearbook 2011
www.worldcompetitiveness.com

Published since 1989 by the IMD World Competitiveness
Center, an activity of the IMD Business School, the IMD
World Competitiveness Yearbook offers a worldwide
reference point on the competitiveness of nations, ranking
and analysing how an economy manages the totality of
its resources and competencies to increase the prosperity
of its population. This edition covers the competitiveness
of 59 economies on the basis of over 300 criteria, and
selected data is available to be manipulated online free of
charge. For the year 2010, Australia was ranked in 9th and
New Zealand was in 21st place.

OECD launches Better Life Index
www.oecd.org under Topics

In May 2011, the OECD unveiled a new, interactive index to
enable people to measure and compare their lives in a way
that goes beyond traditional GDP numbers.

Called Your Better Life Index, the tool is part of a
larger OECD Better Life Initiative that aims to measure
well-being and progress. The index allows citizens to
compare lives across 34 countries, based on 11 dimensions
— housing, income, jobs, community, education,
environment, governance, health, life satisfaction, safety,
work-life balance — giving their own weight to each of
the dimensions. The index was launched as part of
the OECD’s 50th Anniversary Forum and Ministerial
celebrations in Paris.
Oikocredit presents Social Performance Report 2010

www.oikocredit.com under Publications

According to Oikocredit’s Social Performance Report 2010, released in June 2011 in Tanzania, more than 28 million people benefited from financial support through its microfinance partners, with over 1.2 million individuals directly benefiting from Oikocredit funding. An impressive 86 per cent of those who accessed financial services through Oikocredit partners are women, and the small and medium-sized enterprises that receive Oikocredit funding provide 61,000 people with permanent jobs.

Oikocredit’s total development financing portfolio amounted to €481 million with €388 invested in microfinance and €93 million in social enterprises. Oikocredit partners include over 230 cooperatives and almost 50 fair trade organizations.

New blog: Development that works

www.iadb.org under Blogs

The Inter-American Development Bank has launched a development effectiveness blog, which highlights effective ideas in the fight against poverty and exclusion in Latin America and the Caribbean. Monthly e-alerts and other online resources are available, as well as updates on projects undertaken by the Bank.

Employment

Freelancer.com wins Internet honour

www.freelancer.com

In the 15th Annual Webby Awards, Freelancer.com won best Employment Site of the Year in the categories of both Webby and Webby People’s Choice awards.

With nearly 10,000 entries from all 50 US states and over 60 countries worldwide, the 15th Annual Webby Awards are the biggest in its history. Freelancer.com was the only Australian company to win a Webby. We reported on the launch of its Australian site in October 2010. There are now 10 national sites and one global site.

Internet

United Nations declares Internet access a human right

www2.ohchr.org/english/

In a recent report, the United Nations (UN) announced that disconnecting someone from the Internet is a human rights violation. The statement was in response to the passing of laws in France and the United Kingdom banning violators of copyright law from the web. The UN also called for all countries to refrain from cutting off the Internet during political unrest.

The report was presented to the United Nations Human Rights Council seventeenth session on 16 May 2011, and was authored by Frank La Rue, special rapporteur to the UN.

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