



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## SENATE

SELECT COMMITTEE ON SUPERANNUATION

**Reference: Superannuation and standards of living in retirement**

THURSDAY, 8 AUGUST 2002

SYDNEY

BY AUTHORITY OF THE SENATE

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**SENATE**  
**SELECT COMMITTEE ON SUPERANNUATION**

**Thursday, 8 August 2002**

**Members:** Senator Watson (*Chair*), Senator Sherry (*Deputy Chair*), Senators Allison, Buckland, Chapman, Hogg and Lightfoot

**Senators in attendance:** Senators Buckland, Chapman, Hogg, Sherry and Watson

**Terms of reference for the inquiry:**

To inquire into and report on:

The adequacy of the tax arrangements for superannuation and related policy to address the retirement income and aged and health care needs of Australians.

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**Committee met at 1.50 p.m.**

**CHAIR**—I declare open this seventh public hearing of the Senate Select Committee on Superannuation's inquiry into superannuation and standards of living in retirement. Under its terms of reference, the committee is inquiring into 'the adequacy of the tax arrangements for superannuation and related policy to address the retirement income and aged and health care needs of Australians'. Today we will be taking additional evidence from the peak industry organisations, ASFA and IFSA, as well as from APRA. I thank both industry organisations for agreeing to further hearings as part of this inquiry.

The committee has previously flagged a number of issues which it wishes to hear about in more detail from your organisations, including in relation to the modelling of future projections for retirement incomes, as well as in relation to the issue of fees and charges. We are also keen to hear about what might be done to remedy the transitional problems facing the baby boomer generation.

I am pleased to have witnesses from APRA attending this hearing later today. There are a number of issues which have been raised during the course of this inquiry directly relating to the supervisory role of that agency and issues arising in relation to the safety of small superannuation funds, which we are keen to explore.

All witnesses who appear before the committee are protected by parliamentary privilege with respect to the evidence they shall give. This means that witnesses are given broad protection from action arising from what they say. The Senate has the power to protect them from any action which disadvantages them on account of evidence given before the committee. The committee prefers to conduct its hearings in public. However, if there are any matters which you wish to discuss with the committee in private, we will consider your request.

[1.52 p.m.]

**ANDERSON, Dr Michaela, Director, Policy and Research, Association of Superannuation Funds of Australia**

**CLARE, Mr Ross William, Principal Researcher, Association of Superannuation Funds of Australia**

**SMITH, Ms Philippa Judith, Chief Executive Officer, Association of Superannuation Funds of Australia**

**CHAIR**—Welcome. I thank your organisation for the supplementary submission that you have provided to the committee in response to our questions on notice from the previous hearings. It is very comprehensive, as was your original submission. Do you wish to make any additional opening statements?

**Ms Smith**—As you indicate, we have put our supplementary submission in written form and we have focused on our analysis of the Treasury projections as to adequacy, which we believe paints too rosy a picture in terms of the current savings situation. Since we have put this in, Treasury have made some comment and we are happy to comment again on their commentary on our commentary, if you like. I also draw the committee's attention to our supplementary submission where we tried to address questions raised by the committee about how to deal with the impact or the potential cost of our recommendation of reducing or removing the contribution taxes. But I am really in the hands of the committee as to where you would like to focus your attention.

**CHAIR**—As a committee, we believe we have to reconcile the difference between your projections and Treasury projections. If there were just a couple of thousand dollars difference per annum it could be explained, but I do not feel happy with the big gulf that currently exists. As a committee, we must use our best efforts in the next few weeks to try to find out why this gulf arises and whose figures approximate that which we independently assess to be reasonably accurate. There are so many factors that I think it would be remiss of our committee if we put down a report without really satisfying ourselves about this issue. So that is No. 1.

Are your figures too conservative, or can they be lifted a few thousand? Can it all be explained by differences between the CPI and average weekly earnings, as Treasury have said? That seems to be too big a gap, in terms of dollars per annum, between those two figures. Or have you some calculation to explain that? If that is the case, we can accept it and can make our recommendations accordingly. But there is a big difference in what people can expect, and it is a critical amount—

**Ms Smith**—And it is critical to public policy.

**CHAIR**—Absolutely.

**Ms Smith**—I will ask Ross to go through the detail but, as we have detailed, they are partly explained by the conflicting mix of using average weekly earnings, the CPI and the end outcome of that. It also amounts to whether you try to build in a relativity about future living standards or are using living standards that amount to the living standards of 30 or 40 years back. They are two fundamental points. But I will ask Ross to deal with it, because he has waded through it all.

**Mr Clare**—We would be the first to admit that the modelling issues are not entirely straight-forward—there are some technical aspects—but we will try this afternoon to do our best to explain it in the simplest terms possible. You have already identified one of the major differences between the Treasury approach and the ASFA approach in terms of the use of the deflators—the average weekly earnings adjustment that we make and the CPI adjustment that Treasury makes. Over a short period, there is not a great difference between the two but, when we are talking about periods of 30 or 40 years, the difference between the two measures—about 1.5 per cent a year, which is a common assumption between the both of us—accumulates to a very substantial amount. It is the function of the 30 to 40 years.

As to what is the appropriate adjustment factor to use, Treasury claims, through the press release that was issued by Senator Coonan, which you may be aware of, that the Treasury approach is the standard one and that ASFA is using a non-standard approach. However, other very respected researchers use the same approach as we do. I have looked at a number of publications from the National Centre for Social and Economic Modelling. They use the average weekly earnings adjustment both of living expenses and of tax scales. In a way, Treasury are the odd one out in terms of the contemporary researchers, even though they have claimed otherwise in material they have released. I can give you the references for that material from NATSEM. As you would be aware, Anne Harding and her colleagues are world renowned microsimulation modellers and are subject to peer review by academic researchers around the world.

As time has gone on, we have had more ventilation of what Treasury are doing, but, until very recently, it has been very much a black box in terms of some of their projections of adequacy. The more we see of those projections, the more the inconsistencies that appear to be in that model. In some ways, it goes back to that judgment about how you assess living standards in absolute terms. Do you assess them in terms of the living standards that applied when a person commenced their working career, and say that they should be very grateful that in 30 or 40 years the age pension will generate increases in the standard of living that they will share in, or do you assess living standards relative to their last year of employment?

**CHAIR**—What did they assess?

**Mr Clare**—They basically build in future increases in living standards that come from the age pension throughout the entire retirement period. Again, this is not a very standard approach.

**CHAIR**—If it is based on average weekly earnings rather than on a CPI figure, average weekly earnings must take into account some improvement in living standards. That is the mix of the ebb and flow between the bargaining parties.

**Mr Clare**—Yes, and in terms of the community generally, living standards go up over time. I would not fancy going to a meeting of people on the age pension to tell them that they really should be very pleased with the age pension at 25 per cent of average weekly earnings, because it has risen in real terms relative to the CPI over the last three decades. It is cold comfort to them when they end up with a standard of living that is only just above the poverty line relative to contemporary standards. The point we make about the Treasury analysis is that it implies that people should judge their current living standards on the basis of community living standards some decades previously.

**CHAIR**—So the Treasury figure does not include projected contemporary standards of living even though the very bargaining process itself, other things being equal, takes into account productivity improvements to some extent.

**Ms Smith**—That is correct.

**Senator CHAPMAN**—But if it remains at that percentage of average weekly earnings, then, as average weekly earnings take those changes into account, the pension will take that into account, won't it?

**Mr Clare**—The age pension is set at a percentage of male total average weekly earnings. We say that is another reason why our approach to adjusting future costs of living should be undertaken. When you read the material from NATSEM, you can see that they also use that argument. You have focused on part of our case there, and that is only very partially reflected in the Treasury approach.

**Senator CHAPMAN**—So they are basing it purely on inflation rather than on average weekly earnings.

**Mr Clare**—That is correct, and that is the major difference between our two approaches: it is the 1.5 per cent compounding—

**Senator HOGG**—Is that the 1.5 per cent that you speak of?

**Mr Clare**—That is correct. The difference between the annual increase of AWE, on average, and the CPI, on average.

**CHAIR**—Compounding over 30 years.

**Mr Clare**—Yes.

**CHAIR**—We will obviously have to get some sort of independent party—a Vince FitzGerald type of person.

**Ms Smith**—Or NATSEM.

**Mr Clare**—Anne Harding could be an appropriate witness, or Anthony King, who works in that area. They are certainly aware of these issues and the international literature on it.

**Senator SHERRY**—I agree with you, chair, but shouldn't we also ask Treasury to remodel, based on the assumptions that you argue, to see what the outcome of that would be?

**CHAIR**—Yes.

**Ms Smith**—In one of the responses provided through the minister to our submission, they said they had remodelled. There was one particular flaw that we highlighted, you might remember: they had assumed that someone on average earnings by the year 2030 would be on the top marginal tax rate. Because of that, we said, 'Your post-retirement income looks good because of the fact that the pre-retirement income has gone down by that percentage.' They said they had remodelled using our figures of average weekly earnings and had got the same replacement rate. The reason they got the same replacement rate is that, in their calculations, they used a fictional annuity product. They used an annuity product which they assumed was taxed quite heavily. In the real world, annuity products are not taxed. I am saying that there has to be some care in what is being factored into the remodelling.

**Senator SHERRY**—So they have assumed that in 30 or 40 years the current tax concessions for post-retirement products will not exist any more.

**Ms Smith**—That is one assumption. In their paper, in their modelling, the post-retirement products that they use are fictional products; they do not relate to the real world.

**Mr Clare**—They are products that you would be unable to purchase in the market, because they have rates of return which are much higher than the sorts of products they are talking about. They have invented these imaginary income streams which are better than what people can actually achieve in the market. That leads to some distortion.

**Senator SHERRY**—Haven't they also assumed that everyone will do that?

**Mr Clare**—They have put forward a number of different approaches. Some of the taxation provisions are still unclear. When they changed the indexation of the tax scales—they may have done that—I am not sure whether they also indexed the seniors' tax offset. I suspect they did not. They did index, by average weekly earnings, the pension tax offset. One of the difficulties with this black box is that they say they change something but, throughout their model, they do have some inconsistencies in how they adjust things.

**Senator SHERRY**—Isn't there an assumption that there is a total conversion to an annuity pension product?

**Mr Clare**—In some cases, that is what they assume, which is—

**Senator SHERRY**—That does not happen.

**Mr Clare**—It does not happen but, for modelling purposes, it can be illustrative. They have assumed that and then built into it annuity payments which are far in excess of what you can achieve in the current market. They are saying you can get a seven per cent nominal return with no cost or a nominal cost on the part of the provider.

**Senator SHERRY**—No fees and charges?

**Mr Clare**—Yes.

**Senator SHERRY**—That is a world—

**Mr Clare**—Basically, these annuity products deliver just a couple of per cent. They are related to fixed interest. The Treasury modelling says they get a good return and the recipient receives it as during the accumulation phase. We could increase adequacy measures by inventing better income streams in retirement through just assuming them, but the ASFA work is building in actual market rates. I think Treasury can replicate our work quite well using the same assumptions.

**CHAIR**—We will ask them to do that, but we will also ask you to do something, if you would not mind. This is an endeavour to try and satisfy ourselves on the two. Can ASFA do the cameos that Treasury has done, using your assumptions, so that, hopefully, we can then compare like with like? Is that possible?

**Mr Clare**—Certainly for a number of them. Basically, it is quite easy to do cameos. We have our calculator on the Web and it is very simple to do them. They have some slightly different income streams in retirement.

**Ms Smith**—For the record, I did ask Ross to redo how we looked at our target. We set a target of \$25,000 for someone on average weekly earnings and \$40,000 for a couple. I asked Ross to try to redo those targets using Treasury's assumptions. If we used Treasury's assumptions, our targets would have to be changed from \$25,000 for a single person to \$40,000 for a single person.

**Senator BUCKLAND**—That is confusing for someone like me who is trying to work through this.

**Mr Clare**—It is confusing for me, Senator.

**Senator BUCKLAND**—You are talking about Treasury taking your calculations and then using their assumptions. What the chair is suggesting is that you go away and do theirs and we will ask them to do yours, using the same assumptions. Someone has to come to the middle ground somewhere. We do not seem to be finding that.

**Ms Smith**—I agree with you. It is critically important that we can compare a clear target for people to understand. Part of the community education, if we want to be honest to the public, is that we have to set some goals which they can work towards, and perhaps—

**Senator BUCKLAND**—You are setting goals. I might be wrong, but these goals have to be standard for everyone to do their modelling on, not put their assumptions in. We all have to work off the same assumption, surely.

**Ms Smith**—This is the very point.

**CHAIR**—That is the point. We have two different outcomes.

**Senator BUCKLAND**—Someone has to give the directive.

**CHAIR**—We have to find out which are the correct assumptions and which are the weak assumptions.

**Ms Smith**—That is what we are trying to analyse.

**Senator BUCKLAND**—This is really confusing me, as someone with little knowledge of numbers. I am concerned that everyone is putting their own assumptions. Surely what you are suggesting now is the way to go: go away and do it their way and let them do it your way.

**Ms Smith**—Actually, we have to work out what the right assumptions are.

**Senator HOGG**—In your supplementary submission, on page 8, where you refer to the Treasury submission, you say:

The cameos presented by Treasury are not linked in any way to an objective assessment of needs, or community views and expectations.

I presume that is the real wild card in this whole thing. Is that correct?

**CHAIR**—That is right. It is one of them.

**Senator HOGG**—It is one of them.

**Ms Smith**—Yes. It relates to what the relative living standards will be in the future.

**Senator HOGG**—Do you have an objective assessment of needs or community views and expectations?

**Ms Smith**—Yes, and we laid them out in our submission before. We looked at people's expectations and then we analysed the ABS household expenditure figures.

**Senator HOGG**—As I understood it, those were criticised by Treasury. Is that correct?

**Mr Clare**—They did not criticise that particular work. They implicitly criticised our translating those numbers into what will be required in 30 or 40 years time. It gets back to how you adjust it. You are starting off your retirement savings now. How do these numbers translate into the future or how do you relate the future outcomes to these current benchmarks? The approach we used, using the adjustment by the growth in average weekly earnings, picks up changes in community living standards. Basically, what people will be spending their money on in 30 or 40 years time will not be the same as what they are doing now at a similar income level. It is a slightly difficult concept in analytical terms but it is a very important one.

A great gap in the Treasury analysis is that they cast around for numbers that other people have put up and say, 'If you calculate it our way, this number is bigger than that other number.'

But they are not very comparable. It is like the casting around for the 53 per cent replacement ratio. The replacement ratios are less sensitive to these questions of CPI and AWE. There are some other things in the Treasury analysis which tend to inflate their replacement ratios. They may be legitimate methods of assessing adequacy but, when they start relating it to a benchmark that has been calculated on a different basis, they fall into a logical trap. That is where I have less of a problem with their replacement ratios prepared in a comparable way or even their alternative methods in an abstract sense. They have problems in then getting a benchmark for them, as they tend to pluck at a number which has been developed and applied to a different benchmark and say, 'When you apply it to our different measure, our different measure is more than this other number.' But they are not in essence comparable. There are quite a few dimensions to this adequacy debate, as I am sure you are beginning to appreciate.

**Senator HOGG**—Are you able to put it in simple terms for the committee? Obviously we need to be able to explain it to a wide range of people and, unless it is in simple terms, the complexity of the argument will be lost on a lot of people.

**Mr Clare**—We understand that. We will continue to endeavour to do it, but—

**Senator SHERRY**—A line-by-line comparison of what Treasury says and what your assumptions are would be useful. You can do it by getting the Treasury document, your document and your response and setting them down. A column-by-column comparison would be useful.

**Ms Smith**—You could get lost in that, I think. That is why we were trying to simplify it, and saying: 'The major difference goes to some things being indexed by average weekly earnings and some by CPI. Are we trying to build in a relativity factor of future living standards or just have it as a time-warp approach from the past?'

**Senator BUCKLAND**—That is hard to do. We tried to do that but I do not know what assumptions everyone is using. It would be very handy if someone could do it.

**Mr Clare**—I will prepare a table for you with the major assumptions and columns for Treasury, ASFA and, perhaps, NATSEM and any other objective commentators. I discovered that they shared a similar approach only when I went looking after some of these recent developments. I think that would also help in saying what is the standard approach by people who do this work and who have professional and academic qualifications. I will try for as many other sources as I can and do the assumptions in a way that can be best understood. The differences relate both to the relative replacement rates and the absolute levels, and there are about half a dozen different assumptions that lead into it. We appreciate that that makes difficult the telling of the message in simple terms. We will struggle to make it simpler, but we will do our best.

**CHAIR**—Therefore, would it be possible to fulfil my original request about your using the Treasury cameos—not 25 and 40, but their 29, or whatever it might be, and your 19—but using your assumptions? Then, if we ask the Treasury to do the same, we will start to bridge the unknown ground that we are struggling with. They might come back to us and say, 'You have questioned this seven per cent annuity right which you believe is too high.' On the other hand, they might come back to us and say, 'Over the last 15 years, while it might not be the rate today,

the rate is actually 7½ per cent so we have conservatively said seven per cent.’ Can you see why we have to be very careful?

**Mr Clare**—I can understand that, but annuity products reflect fixed interest rates and accumulation reflects both a mix of debt and equity. So, unless they are really reinventing annuities in a way that the current law does not allow, as some people have asked them to do—our good friends at IFSA have been arguing quite strongly for what are called ‘growth pensions’—

**CHAIR**—That is right.

**Mr Clare**—If they were in there as real policy, that argument would be sustainable, but they are not. They are very peculiar private retirement income streams that Treasury is assuming rather than—

**Senator SHERRY**—Perhaps Treasury have conceded on that issue without a public announcement.

**Mr Clare**—It is possible. That is one of the basic problems, in that—

**CHAIR**—Are they likely to come back to us with the argument that it might not be relevant today but, over time, the seven per cent is probably more realistic?

**Dr Anderson**—Not unless you change the law.

**Mr Clare**—Because basically you cannot get a seven per cent return unless you take on the risk of variable returns. Annuity products offer a fixed return, and life company actuaries require good life companies to have those sorts of assets backing them. So, unless you have a fundamental change in investment markets with much higher returns—

**CHAIR**—Or a higher rate of inflation.

**Mr Clare**—That tends to even out because it is the gap between average earnings and the CPI which drives most of this.

**Senator SHERRY**—On that point, I would think it would be hard for Treasury to maintain a position of 7½ per cent anyway given that they are projecting lower real productivity over the next 20 years. Returns are also affected by productivity because they reflect the growth of the economy.

**Ms Smith**—In their accumulation phase they are projecting growth of 4.5 per cent in real terms. That is the same as the ASFA figures. We were both using the same figures as being realistic long-term projections.

**Mr Clare**—It is just that they are saying that you get the same rate of return in the retirement phase, including in annuity products. Whatever the level is, we do not see that as possible as the law currently stands. The level of fees and charges in those products seems to be—

**Senator SHERRY**—Higher.

**Mr Clare**—No. In terms of the retirement phase, they seem to be very cheap and very high-return income streams that current retirees would be delighted to have. If they could achieve what Treasury is assuming in their modelling, they would be much happier than they are now. In our work we reflected market rates—which we thought was a reasonable approach—rather than inventing more remunerative arrangements in the future without a sound basis.

**CHAIR**—The other issue is that Treasury told us that people are going to be better off relying on part pension, part superannuation guarantee. It appears that there will be a huge increase in paying pensions on average weekly earnings in 30 years time, which a lot of people had not realised, because what people are putting away will only give them the equivalent of about 80-odd per cent of the age pension. Given that about 90 per cent of people are going to be on 80-odd per cent of the age pension, is it realistic that the age pension provides that sort of money? We have also got to get right this question of interaction between dependence on an age pension and on what you put in yourself. I know it could have political overtones down the track. Can you express a view on that, in terms of affordability?

**Mr Clare**—The Treasury modelling shows that there is affordability even though the age pension will grow relative to the CPI. That link to average weekly earnings means that it does not grow that much as a percentage of gross domestic product. When you look at the government expenditures on the age pension, even factoring in the ageing of the population structure, Treasury says—and I am not disputing them on this—that age pension expenditures will grow from about three per cent of GDP to 4½ per cent, and that is basically affordable. Most countries around the developed world, and even those in the developing world, would be very pleased if they could keep their government expenditures on the age pension to 4½ per cent of GDP. The fact that in the future the majority of retirees will be reliant in part or in whole on an age pension is not necessarily a problem in terms of the affordability of the system. If there was a massive increase in the government funded age pension in terms of the rates relative to wages—if it was 40 or 50 per cent of male total earnings—then there would be some affordability questions, but on the modelling that has been done—and we are not disputing it—it is affordable for government. That is one of the reasons why we are pointing to the capacity of government to further assist the private provision. We have an affordable, but not very adequate, age pension. What we need is a more adequate private provision to supplement the age pension. It is all about adequacy rather than sustainability for the economy.

**Ms Smith**—In our submission we pointed to the need to look at that interface between the age pension and private savings. There are two goals: one is improving the adequacy—Ross has said it is affordable—and the other is implicitly to reduce the reliance on the age pension where possible. We have highlighted in our report that, in a mature system, we should be anticipating savings in the order of about \$300,000 or more for someone on average earnings. That is exactly where the income and asset test is not operating in a good way. There is a host of anomalies, particularly with the asset test, which is acting in a much more punitive way than the income test. That really has to be looked at to ensure that we have the balance right and that, at the same time, we are giving incentives to people to save.

**CHAIR**—Absolutely.

**Mr Clare**—You may be interested in asking the Treasury officers about their cameos of projections for retirement incomes when a lump sum is taken. There is not much variation in the income received by individuals, even though they might work for more years or are on higher salaries, because, in those cameos, the asset test tends to equalise outcomes. Some of their cameos demonstrate that the current means test actually penalises greater self-provision. It is only when a complying annuity is used that the individual can achieve a greater income in retirement. The cameos that Treasury has put forward show some real peculiarities in the means test, and we have identified a number of those in our submission.

**Ms Smith**—It is in the savings range between about \$280,000 and \$350,000 that some real crunch problems are emerging.

**CHAIR**—I think we have to ask you the question, as well as asking our ourselves the same question: is it appropriate for a person who works for 40 years on average weekly earnings or slightly more to still get most of the age pension? You might say, ‘Why do you ask that question?’ Alternatively, we could increase the pension for those who really need it and lower it for others, so we would be making everybody better off by bringing it to a standard of living that will be higher for all, rather than being up for some and down for others. We have to satisfy ourselves about this.

**Ms Smith**—I think we posed that question ourselves in our first submission to you. We indicated in our scenarios—using 30 years—that for someone getting to \$19,000 we had assumed a full age pension. We said to you that, on grounds of public policy, the anticipation really should not be for a full age pension at those levels; it really should be more of a part age pension. But we have to be careful because we have been assuming, and the savings gap becomes that much greater if you are assuming a part. But we would tend to agree with you that in those sorts of scenarios—and we really have not firmed exactly where that balance is—it should be a part rather than a full pension.

**Dr Anderson**—If you are assuming they will not get as much access to the public pension, you have to ensure they can save more for the private. There is a balance required there. At the moment, we cannot get to the goal we have without assuming the full public support.

**Mr Clare**—It also comes back to the right sorts of taper rates and the means test. At the moment, complying annuities are treated very leniently and other forms of private income and assets can be treated quite harshly. We would say that you will get the right interaction between private and public provision if you get the taper rates right. At the moment some of those taper rates are too harsh, and I suspect some of them are too lenient. We are arguing for better interaction. If you do that right, the equity will improve. At the moment there are anomalies, and we would be the first to say that.

**CHAIR**—Is there any further input from the opposition on this topic?

**Senator SHERRY**—No.

**CHAIR**—From the government?

**Senator CHAPMAN**—No.

**CHAIR**—So we basically agree that, as a policy position, we should be aiming to lift those at the bottom a little more, without coming to some absolute amount. Philosophically there is a need to adjust those at the bottom.

**Senator SHERRY**—But it is important in any retirement income system. The outcome for people on higher incomes will be a higher outcome.

**CHAIR**—Of course. That is what we would recognise.

**Senator SHERRY**—That is an outcome of almost every retirement income system in the world.

**Ms Smith**—So in respect of the replacement rates for people on lower incomes, your target would tend to be higher for those people on lower incomes, but in terms of absolute amounts. As we have highlighted, we agree, but, with the policies as they stand, it is quite often the people on middle incomes—the \$40,000 to \$60,000 group—who need some additional support for improving their own self-reliance.

**Senator SHERRY**—I was going to get to that. I was going to make the point that if we had the 15 per cent contributions and the three and the three co-contribution, this problem that we are debating would be relatively easy compared to contribution levels of nine per cent, wouldn't it?

**Ms Smith**—Absolutely.

**CHAIR**—At the IFSA conference, Dr Vince FitzGerald put down a paper in relation to co-contributions. In terms of adjusting contribution taxes vis-a-vis a government up-front contribution to superannuation, his view, as he explained to me after the session, was that the people at the bottom end of the barrel—the lower-income earners—would be better advantaged in what they can expect out of superannuation not by a general decline in the contributions tax, but by a government either co-contributing or contributing at the bottom end. Would you comment on that?

**Dr Anderson**—If it is the co-contributing—

**CHAIR**—No, either co-contributing or contributing at the bottom end.

**Senator SHERRY**—If they do it for everyone at the bottom end—

**Dr Anderson**—Co-contribution is a problem. Co-contribution is always a problem for people at the end, because it assumes that they have enough cash lying around to do something and then the government matches it. That is always a problem with the people at the bottom end of the economic scale.

**CHAIR**—You could put any numbers you like in. You could say, 'You put in \$1 and the government will put in \$10.'

**Dr Anderson**—The point is that they have not got the \$1 to put in. That is the problem with it.

**Ms Smith**—It always assumes that there is some discretionary income. We agree with him. The proposal he was putting forward was to change the parameters of the co-contribution arrangement to extend it so that it was available for middle-income people. As a way of doing that, but to reduce costs, you could perhaps reduce the matching from dollar for dollar to 50c in the dollar. We have also said that perhaps you could have a family income cap as another way of putting—

**CHAIR**—But you could do lots of combinations of that.

**Ms Smith**—Yes, but can I just reiterate what Michaela was saying: the co-contribution is most likely to help middle-income people who have some capacity for discretionary money—who have some money around to put up so it can be matched or part matched. That could be a very valuable tool, particularly for middle-income people. For lower-income people, the advantage of dropping the contributions tax is that it helps everyone, even if you do not have any discretionary income. We have done some calculations on this. If you took away the 15 per cent contributions tax for someone on \$25,000, after 30 years in the work force they would get a lump sum of about \$183,000 rather than \$130,000. They would be about \$53,000 better off.

**Senator SHERRY**—That is a guaranteed outcome, isn't it? There is no discretion, there is no option; it just happens.

**Ms Smith**—Yes, it happens. It is not requiring them to have any discretionary money; it just happens for them. It adds to the adequacy of their savings effort as it stands.

**CHAIR**—But the whole purpose of the question is: if the government is not increasing the tax take as earnings rise—moving with those earnings—and assuming you do not want governments to take an increasing share of the savings cake, and because more and more money is also going in and attracting contributions, what is the best way to distribute that reduction, where there is a case for some reduction? Is it basically to reduce the contributions tax or do you target it, in terms of some of the variations that we put forward—not necessarily the one that the government has just put forward but variations of that to assist those in greatest need, so that we do not have in retirement some up here and the great bulk of our population down there?

**Dr Anderson**—The first simple answer is that, if you say to people on \$20,000 or \$25,000 a year, 'You put some money in and we'll give you some extra,' it will not work.

**Mr Clare**—Except for rich men's wives.

**Dr Anderson**—Except for rich men's wives—that is right. So that will not work. Taking the tax off is the quickest and simplest way to do it. You just take the tax off.

**CHAIR**—I know it is simple, but is it the fairest way in terms of the lowest-income earners? They pay so little tax anyway.

**Ms Smith**—I would say it is the only way for low-income earners.

**Dr Anderson**—For low-income earners, it is. It is the only way.

**Ms Smith**—The co-contributions, we say, are a valuable tool but probably for middle-income earners.

**Senator SHERRY**—Regarding the take-up rate of the co-contribution—I am trying to refresh my memory; the figure may not be accurate; it might be more—I think Treasury assumed that 200,000 people would take it up, which, as a percentage of low- and middle-income earners, is about 10 per cent, isn't it?

**Mr Clare**—Yes.

**Senator SHERRY**—Less than that, I think.

**Mr Clare**—Their number comes from those who use the existing rebate, and they are mostly people on part-time salaries in the public sector and the like, where there is a compulsory member contribution. For whatever reason, their income in the tax year is low enough to fall within that group.

**Senator SHERRY**—That is an interesting point. Do we have any figures on the number of people who are voluntarily putting additional contributions into superannuation at that low-income level as distinct from those for whom it is compulsory? There are quite a lot of lower-income people, for whom it is compulsory to contribute money, who will benefit from that co-contribution.

**Mr Clare**—There is no real data on that, I am afraid.

**CHAIR**—Dr Michaela Anderson is still hung up on the government's formula. We can vary that formula tremendously by having no employee contribution at all and having a contribution of—

**Dr Anderson**—A credit arrangement.

**CHAIR**—An amount of money. How does that appeal to you, in lieu of a cut in the contributions? We have to try and explore all the options that are open to us.

**Dr Anderson**—Yes, but I cannot see why you would want to do that when you can just achieve it by not—

**CHAIR**—What we are saying is that, by doing that, we would give them the biggest bang for their buck at the top end rather than at the bottom end. That is what worries me on that proposal. They will get a saving but nowhere near as much as you and I will get.

**Dr Anderson**—So at the bottom end, you take it out with one hand and you throw it in with the other? That is the contribution. You take it out and put it back in.

**CHAIR**—Yes.

**Ms Smith**—That is a complicated way of doing that.

**CHAIR**—But would you agree, though, that lower-income earners get a better retirement benefit out of that than by just reducing—

**Ms Smith**—We are saying that, in our minds, when you are looking at who you need to target, it is the people earning \$60,000 and less who need the greatest assistance.

**CHAIR**—Rather than those earning less than \$25,000 or \$20,000?

**Ms Smith**—Yes. In absolute terms, those earning less than \$25,000 will always need the greatest assistance. We are probably already achieving replacement rates of close to 80 per cent. We can improve that a bit more.

**Senator CHAPMAN**—Using a pension.

**Ms Smith**—We are dealing with both absolute figures and relative living standards here.

**Mr Clare**—It comes down to who those people are. Are they people in very poor jobs? Do they have a spouse who is a higher-income earner, and the family income is higher? Is it a part-year phenomenon, with someone starting or finishing work? There is also the question—and some of the members of the committee have raised it—of people catching up towards the end of their working career. They might have had poor superannuation earlier and have ended up with a better income later in their work career. That is the case for many women. They might have had poor earnings earlier on. Later, when the children have left school or the childcare arrangements are more appropriate for them, they may be in the work force and need to catch up. If you only target the people who are receiving a relatively low income and are involved in superannuation, you might pick up a few of the really deserving people but there will be a lot of noise in terms of others who are within the group but are in a lifetime or family situation which is less deserving on equity grounds. There is the question of people who are on higher incomes who deserve support—we are talking about the middle-income group—and the women catching up after a rather disrupted work career. What do you do for them? We have some illustrations of how our proposal benefits a whole range of groups.

**Ms Smith**—From my perspective, how you deal with some of those equity issues is certainly the RBL; it is certainly the income and assets tests; it is those other mechanisms that go around—

**CHAIR**—Just spell some of those things out. Should we take away indexation from the RBL? Should we take out the age based contributions?

**Ms Smith**—I have always thought the age based contributions are rather odd, because people have different opportunities during their work life to save, and we are assuming a constant pattern. A lifetime RBL seems to better capture it. It is dangerous to freeze things in time, because again you have the relative living standards.

**Senator SHERRY**—Is the RBL indexed to CPI or to average wages?

**Mr Clare**—It is at average wages, like most of the tax things in the system.

**Senator SHERRY**—Believe it or not, I was not going to talk about tax today! I want to go back to this basic issue of adequacy. We had a conversation earlier and you differ from Treasury. I understand that. But isn't it true that, even if Treasury were right—and there is a big question mark there—we can clearly identify a number of groups who the current system will not deliver for in terms of a reasonable retirement income? Let me summarise. The current system will not deliver on a reasonable replacement rate for people who have only been in the super system for the last 15 years, people who are 40 years of age and older. It will not deliver for self-employed people, because we only have one-third actively contributing. It will not deliver for middle- to high-income earners, people who earn about \$50,000 to \$80,000. And there are some serious issues in terms of an outcome for women, because of the issues that we have discussed. It seems to me that they are the four groups that, even on the Treasury modelling—agree or disagree—the current system cannot deliver adequately for. There may be others, but they are at least four significant groups.

**Ms Smith**—On our scenario, the system will not adequately deliver even for people who are in the work force for 30 years.

**Senator SHERRY**—But you would agree that, even on the Treasury modelling, those groups cannot make it?

**Ms Smith**—Yes, probably.

**Mr Clare**—Relative to the other outcomes, they will do worse. But we have proposals in a number of those areas. In terms of the self-employed—

**Senator SHERRY**—I know you have those, but the difficulty we have is finding out where the problems are. It is really hard to identify the solutions if we cannot get agreement about where the problems are.

**Ms Smith**—My only caution, and why I said it, is that it is broader than just pockets.

**Senator SHERRY**—The groups I have just outlined are very substantial pockets.

**Ms Smith**—Yes.

**Senator SHERRY**—The 40-plus age group is a quarter of the population.

**Ms Smith**—They are going to be a very noisy pocket.

**Senator SHERRY**—I am sure they are. The 40-plus are a very substantial pocket. People earning between \$50,000 and \$80,000 are a very substantial pocket. Women are a very substantial pocket, and the self-employed are a very substantial pocket. I am not underestimating the pocket.

**CHAIR**—They could put you out of government.

**Ms Smith**—Yes, a lot of minority groups.

**Senator SHERRY**—They add up to a majority of the population if you look at it; they are not minority groups.

**Senator HOGG**—In your supplementary submission, you referred to lowering the \$450 a month earnings threshold, but you do not say to what. There obviously should be a minimum once you take charges out and so on. Do you have a view as to what the minimum should be?

**Ms Smith**—We are consulting on that with our members at the moment.

**Dr Anderson**—The reason we said that we may be able to lower it was that, if you did your sums, you could say: ‘We started at three per cent, and put it at \$450. Can we use the same assumptions now we are at nine per cent?’ But we do not have a full policy on that, as Philippa says.

**Ms Smith**—It may be around the \$150 mark, but we have to test that with our membership.

**Senator HOGG**—How long before you have a firm view?

**Ms Smith**—Two weeks.

**Senator HOGG**—I was not trying to pressure you. I am just trying to get an idea of whether you have something with the currency of this—

**Ms Smith**—We are being serious. We want to put that to our policy committee and see what the—

**CHAIR**—That is less than two days work a month.

**Dr Anderson**—Yes, but it is nine per cent of—

**Senator SHERRY**—At \$5,400 a year, it is \$450 to \$500 a year in SG contributions at that cut off.

**Dr Anderson**—The question that we are putting to our members is in terms of member benefit protection—how they are feeling about that at the moment, especially with low earnings.

**Senator SHERRY**—I have got an open view on it, but is it worth lowering that? Are the contributions of \$450 for a person on \$450 worth it?

**Dr Anderson**—It became an issue when we were looking at the quarterly contributions. That issue of \$450 a month was raised then, and it was raised again in terms of some worry about member benefit protection in a climate like this.

**Ms Smith**—But with changing work patterns, what was reported to us during those consultations was the increased frequency for people in casual work to have multiple employers. What they are doing is patching together an income from a variety of employers.

**Senator SHERRY**—Because it is per employer.

**Dr Anderson**—Yes.

**Ms Smith**—It is a threshold per employer.

**CHAIR**—Would it not be better to legislate that, in lieu of under a certain figure per month, the employer puts that into the wage component rather than superannuation?

**Dr Anderson**—I think the employers would have something to say about that, because they would be doing two different things.

**Mr Clare**—That notion has been around before, and it is a difficult one, especially when you have a less regulated wage market. Nine per cent on top of something that is not defined is not a very valuable right. That is one of the worries in the areas where something could be said to be in lieu of—the base figure is not always determined. It is a difficulty in any proposal to cash out a superannuation entitlement.

**Senator HOGG**—But going to a lower figure—and given the scenario that you have described of different work patterns—it could be significant to a person's retirement contributions if that figure is substantially lowered.

**Ms Smith**—Yes, absolutely.

**Mr Clare**—But our members certainly have views on the subject. We are in the midst of a road trip around Australia—

**CHAIR**—I think that question has to be asked.

**Mr Clare**—They ask it and discuss it fairly vigorously.

**Senator HOGG**—Vigorously?

**Mr Clare**—Yes. The superannuation industry is a very vigorous one.

**CHAIR**—There being no further questions, thank you very much for your attendance today. I think we are a lot more informed than when we started.

[2. 51 p.m.]

**GILBERT, Mr Richard, Chief Executive Officer, Investment and Financial Services Association Ltd**

**STANHOPE, Mr William, Senior Policy Manager, Investment and Financial Services Association Ltd**

**CHAIR**—Welcome. On behalf of the committee, I would like to thank your organisation for the additional information you have provided following questions at the previous hearing. We look forward to receiving the remainder of the material as requested. I am aware that your organisation held its annual conference for members last week, and we would welcome any reports from that conference on issues you believe may impinge on our current inquiry. We invite you to make an opening statement, in addition to the matters we have just suggested to you.

**Mr Gilbert**—Thank you. We have followed up with most of the answers to the questions that you asked last time. We still have work in progress on a small number, and I hope they will come to you fairly soon. We found the previous hearing to be a very productive exercise. I know that we spoke at length but, equally, we appreciate this second opportunity to answer questions, so my statement will not be a long one.

Last week we released some quite seminal research on co-contributions take-up, which I do not think has been done before. I would like to table that research to allow the committee to ask questions, either now or at a later date. This research was carried out by Eureka Strategic Research. It covered a large and statistically valid sample of individuals from various age groups and it included other socioeconomic demographic characteristics. The important thing about this data is that people across all age groups and all socioeconomic strata are interested in being involved in co-contributions. You will see some cost modelling there, as well as some alternatives to date. That does not mean we do not support the government's current proposal on co-contributions; it means that we want to put on the table some ideas for this committee to think about.

**Senator HOGG**—Do you have that document in an electronic form?

**Mr Gilbert**—Yes.

**Senator HOGG**—That would be preferable for some of us.

**Mr Stanhope**—Yes. The document is on our web site. We are about midway through this project. We have done the population research so far but we are yet to complete the fiscal analysis which, as you probably know, Dr Vince FitzGerald is doing for us. We are about halfway through. We released some preliminary numbers at our conference, but we want to work that out to the end of the fiscal forward estimates period and then do some long-term modelling. I wish we had access to the full retirement incomes modelling, the RIM, but we will have to make do without it.

**CHAIR**—IFSA has tabled a document called *Government Co-Contribution to Superannuation Market Research* by Eureka Strategic Research. Is it the wish of the committee that the document be tabled? There being no objection, it is so ordered.

**Mr Gilbert**—In finalising my opening statement, we are very happy to answer questions on any area of the inquiry's terms of reference, but we would like to go away having had at least one or two questions on growth pensions.

**CHAIR**—You would like us to ask some?

**Mr Gilbert**—If you could, that would be very helpful because we think that they are a very important public policy issue.

**CHAIR**—That is a leading question for the committee to respond to.

**Senator SHERRY**—In view of the conversation which we had with ASFA, which you were not here for, and the assumptions that Treasury made, it seems that Treasury modelling is based on the assumption that growth pensions are available—at no cost, by the way.

**CHAIR**—We had better explain why that is the case.

**Mr Gilbert**—My members could not agree with that.

**Senator SHERRY**—I understand, but we found it fascinating that the Treasury has actually assumed this.

**Mr Gilbert**—Yes, the cost to revenue. I thought you meant no fees.

**Senator SHERRY**—No, I do.

**Mr Gilbert**—You do?

**Senator SHERRY**—That is what the Treasury has assumed.

**Mr Gilbert**—I would like to advise the committee that we cannot offer those products.

**Senator SHERRY**—The Treasury has accepted the policy. It is going to be there in 30 or 40 years time, it is going to be operating, they have accepted it, but they have not announced it yet.

**Mr Gilbert**—That is very encouraging.

**CHAIR**—I have a question for Mr Stanhope following on from Senator Sherry's question. We have been told that the seven per cent annuity return under current law is basically unachievable in current market circumstances unless, as ASFA said, you introduce the concept of a growth pension. It is related to the asset base.

**Mr Stanhope**—It is related to the asset base. Provided you are asset test sensitive as a retiree, in the current market you have a product called a life expectancy pension, which is a form of term pension under the social security rules, with 15 years to your statistical life expectancy. Because there is a guarantee on the income level, that is, it cannot vary—and I quoting the Social Security Act here—except by indexation, normal asset matching and the sorts of requirements that actuaries have for those sorts of products mean that you effectively have to go into fixed interest products in order to give that kind of income stream because it cannot fluctuate. Even those can be offered only by organisations with substantial reserves, and in that case you are talking about the statutory funds of life offices. That means that you simply cannot achieve a balanced portfolio or even a growth portfolio return on those products because they need to be structured to give effect to those guarantees. That is the first point. I would add to that that what you have in the market is effectively a rate chase. Rather than a quality of income stream, you simply have a headline rate of return in the product and that is what financial planners chase. As you point out, even that cannot match the returns available from a simple diversified balanced portfolio.

**Mr Gilbert**—One need only look at the returns on the various asset parcels over the last 20 years to see that the return on fixed interest is five or six per cent whereas the return on equities is nine or 10 per cent.

**CHAIR**—But according to the Treasury model, they are talking about a return over time of seven per cent. Does that look too high?

**Mr Stanhope**—Without knowing whether that is a real or a nominal rate of return, we have done modelling based on—

**CHAIR**—You have looked at the Treasury presentation?

**Mr Gilbert**—We recently published some data on the last 16 years of returns across the asset classes and I would like to provide that to the committee. They are in both nominal and real. Would that be reasonable?

**CHAIR**—Yes. From what you have seen of the Treasury figures, Mr Stanhope, is that seven per cent return realistic? It could make a big difference to our calculations and we are trying to get a hold on what the quantum should be in terms of the return after 30 or 40 years.

**Mr Stanhope**—It seems a little high. I am not really qualified to comment, but the modelling that we have done assumed a rate of return on balanced portfolios of about 6½ per cent, and four per cent on fixed interest.

**Mr Gilbert**—They are real.

**Mr Stanhope**—Seven per cent and those sorts of terms were based on 15-year averages and they were done some time ago. Long-term averages do not change that rapidly. A number like seven per cent seems, as you say, to imply balanced investments.

**CHAIR**—You have seen the Treasury calculation. Are you happy with that? Does that enable us to make policy recommendations to government?

**Mr Stanhope**—I have not been behind the Treasury calculations, as you probably know. We can look at their assumptions, but nobody can get behind their modelling. We cannot use their model, put in different assumptions and see what that does to the outcomes. I am happy to take that on notice.

**CHAIR**—Somebody has to do it. How can we do it? Can you assist the committee? We have a big difference between the calculations put forward by ASFA and a number of the universities—with some variation—and the Treasury.

**Mr Stanhope**—We could begin to guess about it, but all we would be doing is guessing. Without the model, we cannot replicate its outcomes. We routinely look at proposals to guess policy outcomes and, for us to replicate the work that the Retirement Income Modelling Task Force would do with its various models, RIMGROUP and RIMHYPO, generally speaking costs us in the order of six figures. Clearly, we cannot do that for every policy proposal, and it is a big impediment to open debate on superannuation. If we cannot model outcomes of different policy objectives, it is very hard for us to work out what to recommend to government if we are trying to prioritise between competing options, for example. In the case of the co-contributions research that we have just put on the table, Dr Vince FitzGerald and Allen Consulting will be seeking to run a simplified guess at where the RIM modelling goes. This is in fact an earlier model of RIM, when it was available to the public. But again it is a guess. In a way, what you are doing is spending six figures of industry money to get the Treasury sufficiently interested in an idea to give you the real answer. I suggest to you that that is not an equation that is very helpful to us.

**CHAIR**—Our committee is in a dilemma, because we have two basically robust figures. They are significantly different. The explanation for the difference is given to be the differences in the increase over 30 to 40 years between average weekly earnings growth and CPI.

**Mr Stanhope**—That has been the debate all along.

**CHAIR**—Is that the correct answer and—

**Mr Gilbert**—My suggestion is that this is an actuarial matter and it might be worth the committee securing the services of an independent actuary to assess both models and report to the committee independently. We would prefer not to be involved. We do not have the resources to be involved.

**CHAIR**—No, but we are just asking you whether you have done it and what is involved. As a committee, we have a responsibility to get a handle on what gives rise to these differences.

**Mr Stanhope**—We have said very clearly that we think the model should be in the open so that it can be used. If the number that they have is the right number, that ought to be apparent. Part of the problem is that, without openness about the model and without access to the model for other people to test it, it is very hard to have any notion as to whether their answer is right or wrong. We do not really want to enter that debate at all. We might simply say that, a year ago at our conference, the Retirement Income Modelling Group suggested that, on similar assumptions, the replacement rate for final consumption expenditure in retirement was 62 per cent. The numbers are significantly higher this year. We do not understand the difference for

those. It is not our business to test those assumptions. We do not have that expertise in house. As I say, you would need either an actuary or a modeller to do that. When we are talking about retirement incomes, some of NATSEM's do not go to that. Again, they have fairly simplified models for the draw-down phase.

**CHAIR**—Where do we go? Give us some names. It is a very important issue for us.

**Mr Gilbert**—Can we come back on that?

**CHAIR**—You can take it on notice.

**Senator SHERRY**—Whatever the outcome of Treasury, whether or not it is correct in terms of the income stream, the assumption of Treasury is that everyone does it. My understanding is that not everyone does it, because it is not a requirement at the moment.

**Mr Gilbert**—Mr Stanhope can give us the figures on that. We have data on it.

**Mr Stanhope**—In terms of people taking up income streams, there is market data about who purchases what. If you are talking about income streams that exhaust all capital with the best social security advantages—that is a lifetime income stream—it is about five per cent of the market. The lion's share of the market is in allocated products. Again, provided you live to your life expectancy, depending on the investment performance you may or may not exhaust that capital. One of the points about growth pensions is that they provide for the draw-down of capital. Retirement income models tell you that in a lot of their modelling about fiscal impact they assume no consumption of capital, and in their modelling of adequacy they do assume consumption of capital. The truth lies somewhere between the two. One thing that we have been doing—we would be happy to provide it to you—is 'Desires and Drivers' research which looks at what motivates people who are purchasing a product. After all, for people to do what Treasury assumes in their model, they have to make a product decision: do I want this or that kind of income stream? We found some different features of those income streams which are very powerful turn-ons and turn-offs for retirees.

**Senator SHERRY**—That is useful, but what is the total percentage of people who take annuities when they retire, in whatever form?

**CHAIR**—He said five per cent.

**Mr Stanhope**—We will have to take that on notice. I do not have it to hand.

**Mr Gilbert**—It is in our 'Desires and Drivers' research.

**CHAIR**—Earlier, when you were talking about growth pensions, the terminology that you used differed from what you are talking about today. Today you are suggesting an allocated pension. Earlier, you were suggesting a growth pension with a draw-down facility, which is an allocated pension.

**Mr Stanhope**—A growth pension is essentially an allocated product with a single draw-down factor.

**CHAIR**—Single?

**Mr Gilbert**—It is not often lower.

**Mr Stanhope**—So the point about a growth pension is that you do not have discretion about how much of the account balance you turn into income in any given year; that is done by a single formula.

**CHAIR**—For the *Hansard* record, can you give us an example of a single draw-down?

**Mr Stanhope**—A single draw-down?

**CHAIR**—That is what you are talking about now.

**Mr Stanhope**—At age 65, the draw-down factor—depending on whether you are male or female—is between 16 and 23, from memory.

**CHAIR**—Per cent?

**Mr Stanhope**—No, as a factor, so you divide the account balance by that number.

**Mr Gilbert**—It is the life expectancy.

**Mr Stanhope**—The pension valuation factors in allocated products simply work by dividing the account balance on 30 June in the preceding year by—

**CHAIR**—The life expectancy.

**Mr Stanhope**—by a low number and a high number. Obviously, the high number gives you a small amount, which is your minimum draw-down, and the low number gives you a high amount, which is your maximum draw-down. The difference with a growth pension is that you get one number. What we said to government about that one number is that that number is an outworking of life expectancy. We think that is a public policy debate, which we have ceded to government. We have given government some examples of drawing down a pension over 15 years and 23 years to allow them to work out where that goes in terms of social security outlays and tax. But really that is a trade-off for them, because what are you talking about is the difference between income, tax, social security during life and indefinite tax deferral through estates in death. They are types of public policy trade-offs.

**CHAIR**—In the current environment with very low rates of return, the allocated pension arrangements with maximums and minimums are not very satisfactory. Some people want to try and keep their capital intact because they want to live off their income, and this forces them to dissipate their capital. How do you view that?

**Mr Stanhope**—The allocated products do not force them to dissipate their capital. That is the whole point of the minimum-maximum factors.

**CHAIR**—You have to draw it down.

**Mr Stanhope**—You do have to draw it down. The whole point of the tax concessions that go to allocated products is that you do not pay tax on the earnings of the fund. The reason for that is that you are consuming your capital, which is the principal public policy objective. So if you are in an allocated product and you want to keep your income constant—and there is not a free lunch there—you are going to have to draw down some of your capital. On the other hand, if you want to keep your capital more intact for drawing down later on in your retirement, you are able to say, ‘The earnings on my capital were a little less last year, so I’ll pull in my belt this year and keep my capital for longer.’ The converse is that, with a fixed interest product, you simply would not have those earnings in the first place; you would have a lower but less volatile income pattern. That is simply the price in the market. There is no premium without risk.

**Mr Gilbert**—What is important is that financial planners and individuals, when they are making these decisions, make sure they have a mix between the riskier product and the not so risky product. With the growth pension, you have a choice of three. We would not anticipate that people would be putting all of their money into a growth pension.

**Senator SHERRY**—I do not want to spend a lot of time on this issue today, because we will have another opportunity at another time, but I understand you provided the committee with a number of documents, as per my request—I have not had a chance to look through them all—so thank you for that. Looking at some of these key feature statements, has anyone in the industry tested the level of consumer understanding? Is there any research in that area?

**Mr Gilbert**—Yes. We researched simpler managed investment prospectuses, SMIPs, in conjunction with ASIC about three or four years ago. We also have in our files an ATO research project on three sorts of key feature statements, or PDSs, which were contemplated about four years ago when the government was contemplating choice. I am happy to provide the committee with that information.

**Senator SHERRY**—If you could do that it would help. But there is no research on these types of documents, is there?

**Mr Gilbert**—Some of the individual companies might have it but we have not done any research on it, and I can tell you why. It is because those documents were prescribed and were handed down, as in the tablets of stone from Mount Sinai, or wherever.

**Senator SHERRY**—‘Mount Senate’!

**Mr Gilbert**—‘Mount Senate’, perhaps, or ‘Mount Government’! They were handed down to us and we executed those prospectuses according to law.

**Senator SHERRY**—I understand that. I am interested in whether there has been any testing of levels of consumer understanding of the documents as a whole and, obviously, the fees and charges. Most of the documents are comprehensive; they are 30 to 50 pages long.

**Mr Gilbert**—We did some research on non-superannuation documents, which I am happy to provide. That indicated that people could find the fees and did understand them. I am very happy for the committee to have that research which we did last year. If you would like us to take that on notice, we can do that.

**CHAIR**—Absolutely.

**Senator SHERRY**—What I find difficult with a number of these documents is that the fees are there—and you are right about that—but they are not aggregated into a single fee and it is difficult to assess the overall level of fee. Do you accept that?

**Mr Gilbert**—Absolutely. These products are necessarily complex because they are going to various segments of the market. So whilst it is possible with employer sponsored funds, in the traditional sense, to wrap those people into a single product because of the nature of the relevant constituency or population, it is more difficult to do so in a retail environment. You have to look at whether the product has advice, whether it does not have advice, whether the product has extra insurance, and whether it has disability. They are complex products because they have to serve a complexity of needs. So to come up with a single figure on fees—and I think that was the stem of your question—the best way to do that is through a web site calculator, because everybody has a different set of parameters running.

**Senator SHERRY**—I wonder, practically, how many individuals would access a web site calculator.

**Mr Gilbert**—There is a very high take-up of Internet research or Internet usage. We envisage that it could be done with the companies that are selling the product or, indeed, with financial planning agencies if people are getting advice. If they are not getting advice there, they could well get it at the workplace. Even factory floors now have computers with web access. I think you will find that, as time goes on, that sort of access will be critical.

**Senator SHERRY**—I agree that it is critical.

**Mr Gilbert**—We cannot do it just yet but, ideally, the best thing would be to have a chip in every page. You could probably print out a chip which you could put into one of the pages of the prospectus, saying, ‘Tap the numbers and come up with your result.’ I refer the committee to the Ontario Securities Commission web site.

**Senator SHERRY**—Is that Ontario, Canada?

**Mr Gilbert**—Yes. That web site has on it a working fee calculator approved by that regulator, so it has obviously been through a lot of hoops. It is my intention to work with our regulatory agency to try to come up with something like that. The point is that you can say that the ongoing management charge is false and does not help—

**Senator SHERRY**—I am not saying it is false. I am concerned that it is real, not false.

**Mr Gilbert**—I am just knocking over that straw man. I think the ongoing management charge is a highly representative and highly accurate reflection of what it costs to stay in a fund.

If it were called a total management charge that would be a different matter, but it is called ongoing. There is money going into funds: there are costs going in and costs coming out. So even when you leave an industry fund, you might pay \$50 for a cheque to be drawn as an exit fee but, then again, you might not, depending on how long you have been in the fund or what have you.

The ongoing management charge is what it says it is. It is true to brand: it is all the charges in the fund over the total funds under management as a percentage. People like to use global examples. If you go to the US prospectuses, you will see something called a management expense ratio, which is essentially the same as an ongoing management charge. It is the same with the Canadians and with the British. It is a worldwide practice in savings products to use that particular thing. To then say we want to incorporate entry fees presents real problems because very few people come in and pay the full entry fee.

**Senator SHERRY**—I have not picked out any particular company from these examples; it is just that Royal and Sun Alliance Portfolio Services Ltd is at the top of the pile. Their charges are detailed on pages 3 and 4. The document states:

What are the charges?

Every type of charge that may be charged within Optimum is fully described in this section.

Further on, it says:

Contribution Charges

Up to 5% of regular and lump sum contributions, transfers and rollovers ...

Under 'Ongoing management charges', the document shows an asset charge of 1.75 per cent for the first \$100,000 and up to \$150,000, and a charge of 1.5 per cent for the next \$250,000. It shows a member charge of \$4.80 per month, which is deducted from the account. There is an exit charge of \$50, which is pretty reasonable given some other exit charges. Under the heading, 'What is paid to your adviser' the document states:

4.0% of each contribution;

4.8% of each transfer/rollover;

0.75% p.a. on the total assets held in your Account, paid on a monthly basis; and

25% of each insurance premium.

Firstly, I am concerned about the level of the fees and charges if this is the norm in the industry, because they are significant. I still think it will be very difficult for the average punter out in the real world to work out what the total impact is.

**Mr Gilbert**—In that prospectus we have done what the law prescribes.

**Senator SHERRY**—I agree with that.

**Mr Gilbert**—Equally, some of the products that have so-called simplified pricing structures do not have some of the expenses listed. You are damned if you do and damned if you do not. So it is a real problem. Those were done under the old regime, but when you look at the new prospectuses—there is only one new one—given the product structure, I think it is reasonably simple and straightforward. That is the Colonial one that we sent you earlier.

**Senator SHERRY**—I have that, and I must say that I was concerned. I am not arguing that the fees are not there; the fees are there. My principal concerns are what the outcome is in totality—and we can use a calculator to do that but whether the average punter will be another thing—and what the level of total fees is. I am worried if we have an industry based on these levels of fees.

**Mr Gilbert**—Those products are public offer retail products, which is what you asked for.

**CHAIR**—Which is a different range of products.

**Senator SHERRY**—I am not saying that you have not provided what we asked for.

**CHAIR**—They have a different range of fees

**Mr Gilbert**—Yes, and they cover probably 10 per cent of the population. I pay money into one of those and I can understand them.

**Senator SHERRY**—I hope so, given your position!

**Mr Gilbert**—That is true, but I am saying that that 10 per cent of the population who may use those products use them for a particular reason. I use them because they have very good temporary disability cover. Working in the private sector you do not have great accumulations of leave and you need a complex product. It is a very big advantage to have that. Equally, if I worked in a profession that did not pay the sorts of remuneration that I get and did not require coverage for sickness, I would probably go to a simpler product—and that product might be an employer sponsored product.

**Senator SHERRY**—I am glad you raised that issue. I do not want to go to any more of these statements on the total fees and charges, because we can explore that on another occasion and in another context. As we know, most products offer a death and disability insurance type product, but I am increasingly seeing salary continuance type insurance. They are more expensive products and they take out a substantial proportion of SG, and we have seen some very significant deductions, if we talk about the nine per cent. Should they be allowed? It appears to conform with the current sole purpose test, but does it conform with an income retirement policy principle of maximising retirement income?

**Mr Gilbert**—If they are sold through an adviser, the adviser should clearly identify the needs of the client. One of those needs is the long-term retirement income needs. That is the first thing. Many people buying those sorts of products are putting in more than SG.

**Senator SHERRY**—What if they are not? Let us stick to the SG. I can give you an example of it. At the last committee hearing we had tabled an example of a product taking 80 per cent of the SG contribution. That seems extraordinary.

**Mr Gilbert**—I have not seen all the facts on that one, but an explanation could be—and I am not sure of this—that the person signed that particular contract and the employer stopped sending the contributions, but the person was still tied to pay the premium. That is what may have diminished the balance. I would like to see the facts on that one.

**Senator SHERRY**—We can provide them. But in this case it was an extraordinarily high figure, and whatever the reason—

**Mr Gilbert**—It did sound impossibly extraordinarily high. I could not believe it.

**Senator SHERRY**—But should it be even five or 10 per cent? Super is for retirement income purposes. I accept the death and disability. It is a reasonably modest charge, wherever it is provided; I am not arguing about that. The broadening out of the insurance products that are being offered and the subtraction from the retirement contribution worry me.

**Mr Gilbert**—In our superannuation fees research, we have what the charges are on average. The averages are not high. I do not have them here, but—

**Senator SHERRY**—We have departures from averages.

**Mr Gilbert**—Yes.

**Senator SHERRY**—I am very well aware of the research—and I congratulated you at the time—but there are departures from the average. It is a relatively small number of cases. I do not know whether you listening, but on the John Laws show this morning I said, ‘I am not saying that these are anywhere near a majority—they are a small minority—but they exist. Should we allow this salary contingency insurance at all?’

**Mr Gilbert**—There is a definite tax advantage to the individual by being involved in that, and I think it would be unfortunate if that were withdrawn.

**Senator SHERRY**—I am surprised at that because it seems that we have a conflict with the sole purpose test, which is to provide a retirement income. Fundamentally, should salary continuance provide what effectively is a top-up unemployment benefit on the back of a retirement income system?

**Mr Gilbert**—Again, it depends on how much the individual has elected to put into that. Equally—to come to the tax issue—you can make salary continuances and claim a tax deduction on them. If you are going to attack them in the superannuation context, you probably have to attack them in the taxation system as well, because both involve a tax preference. Do you understand where I am coming from?

**Senator SHERRY**—I understand that.

**Mr Gilbert**—It is a pretty complex one: you could not do one and not the other because there is a transaction cost here. You will be doubling the transaction costs for a person if you take it out of the superannuation environment. That means you have to go to another agent with another set of advice, which is what we are trying to stop in this committee in some cases.

**Senator SHERRY**—In some cases. I do not have anything further.

**Mr Gilbert**—One thing I would like to raise is that there is one piece of data which I did get and I think it would be helpful for the committee. We actually trawled through the Superannuation Complaints Tribunal complaints on fees. The complaints on fees which they reported for July-September 2001 were 1.8 per cent, for October-December they were 1.8 per cent, for January-March 2002 they were 1.2 per cent and for April-June 2002 they were 1.2 per cent. That is the government sponsored Superannuation Complaints Tribunal.

We also went to the Financial Industry Complaints Service, which is run by the private sector and includes superannuation and non-superannuation products. They informed me that they had 1,000 complaints during 2001, 28 of which were fee related complaints—that means a complaint rate of 2.8 per cent. I think it is important that the committee sees that there is a context here and fees are not the No. 1 issue. They might appear to be the No. 1 headline issue in the media but, when you look at the level of disputation about them, the number is small.

**Senator SHERRY**—How many complaints were about tax levels?

**Mr Gilbert**—I do not know; we can find out.

**Senator SHERRY**—Frankly, I would be surprised if they were at the same level as fee complaints, but it does not mean that it is not a real issue for some people.

**Mr Gilbert**—No, but there are disclosure issues. They go to the heart of some of the complexity in the prospectus and whether the adviser explains it in oral terms as opposed to what is written. If disputation is going to happen, that is what it will be about. But it does not seem to be hitting the headlines. Perhaps it could be said that the education processes we have are not good enough. The committee should be thinking about that, and we would seriously think about it too.

**Senator SHERRY**—The SCT does not have power to adjudicate on what an unreasonable fee level is, does it?

**Mr Gilbert**—On fee disputes. The level is a different matter to the information and the advice given.

**Senator SHERRY**—Yes. They are two different issues. The SCT at the moment certainly does not have the power to say, 'Look, that is an unreasonable fee and charge,' and to award any sort of determination and compensation.

**Mr Gilbert**—That is true, but when you look at some of the matters that have been raised in the media about differences of interpretation—what was and what was not said—you would think that the whole industry is involved in this massive dispute with consumers. It is not as

massive as perhaps the media is making out. But we should never be complacent, and I understand that.

**Senator BUCKLAND**—Why should you support some funds having higher fees that are anomalous with the rest of the industry? I struggle with your comments on that.

**Mr Gilbert**—If you work for the government, your average fee rate is 40 basis points, 0.4 of one per cent. In some cases the government is paying for the cost of administering that fund. In our research, we found out that, in corporate funds, employers were subsidising them to the tune of 40 or 50 basis points. So there are two quick reasons. In the case of industry funds, they do an amazing job in keeping costs down, and we applaud them for doing that, but they do have one advantage over retail funds: they have a virtual client base. It comes to them in one cheque from one employer or one industry. It is a very expedient way of transferring funds.

**Senator SHERRY**—It is a very efficient way, isn't it?

**Mr Gilbert**—We applaud them, and that is why we publish it. But not all people are in those circumstances. There are some industry funds which are more expensive than the corporate master trust because they are small and they do not have massive fund flows moving from one employer to the fund.

**Senator BUCKLAND**—But even the non-industry funds have discrepancies between their fees.

**Mr Gilbert**—They do. The top 10 corporate master trusts are running their services at about 85 basis points because they have got scale. They have big IT systems and large tranches of single employer money moving across.

**Senator SHERRY**—But an individual consumer, say a self-employed person, cannot access that level, can they?

**Mr Gilbert**—For an individual, I think the best around in our industry, with no entry or exit fees, is about 1.35.

**Senator SHERRY**—For, say, a self-employed person?

**Mr Gilbert**—It depends on what your volume of funds are.

**Senator SHERRY**—That is the best; what would be the worst?

**Mr Gilbert**—It could be up to 2½. The other thing is that some people—and you might think this is asymmetric—want to come into their superannuation via a financial planner. They say, 'Look, I've got a reasonable income; I can afford a planner. Would you put me in this fund? I don't want to pay you for a plan. I'm very happy for you to take the fees that I would pay you for the advice out of the trail commission.' That immediately adds 50 basis points.

**Senator BUCKLAND**—Okay, but what level of income would that type of consumer have? They would not be at the lower end of the scale, would they?

**Mr Gilbert**—The overwhelming bulk of low-income earners are in industry funds, and they are very efficient.

**Senator BUCKLAND**—What level are we talking about for, say, a self-employed person?

**Mr Gilbert**—A self-employed person could be on \$50,000 to \$60,000 and might want a financial plan, because it could be that they want a wealth creation plan. They might want some advice on capital gains tax rollover for their business or special salary sacrificing arrangements.

**Senator SHERRY**—A lot of self-employed people would be earning less than \$50,000 to \$60,000. That is no justification for them being ripped off, is it?

**Senator BUCKLAND**—I still struggle—

**Mr Gilbert**—Senator, I take issue with the words ‘ripped off’, because people buy these products—

**Senator SHERRY**—Let me withdraw that and say ‘excessive fees and charges’. I am being very restrained.

**Mr Gilbert**—Thank you, Senator. But even ‘excessive’—‘excessive’ is in the eyes of the purchaser. If a person believes they are getting value, it is not excessively charged. If part of that valued proposition is some advice—and I think you should put this to the financial planners when they appear before the committee—and if good advice is being given—

**Senator SHERRY**—I do not think they would come back again in a hurry.

**Mr Gilbert**—If you can organise things so you can salary sacrifice, as opposed to paying your superannuation post-tax, that more than pays for the advice, Senator.

**CHAIR**—We are all in favour of transparency. If a person has \$40,000 to invest—I am not so worried about the level—the adviser might charge them \$500 or \$5,000. If you pay that up-front, you are very conscious of the cost of that advice, whereas, if you do it in the form of a trail commission, it gets lost on you. These trail commissions are an old practice but, in the light of transparency and in the light of simplicity of calculation of total fees, isn’t there really a case to have it all up-front and transparent? Otherwise, you are just talking about getting people further into debt.

**Mr Gilbert**—You cannot. I think it is wrong to deny someone the right to choose that. Our research shows that a very large proportion of investors—I think it is in the vicinity of about 40 per cent or 50 per cent; and we have done this in the non-superannuation environment—want to pay their adviser via a trail commission. So I do not think it is—

**CHAIR**—Can we distinguish then? Would you say there is a—

**Senator BUCKLAND**—How much knowledge do they have of the meaning of that, though? That comes down to the question of education, doesn't it?

**Mr Gilbert**—Yes, but it is in the prospectus and it is explained. We have research to show that they do understand that. We have done that research and are providing it.

**Senator BUCKLAND**—Where is the research that shows that?

**Mr Gilbert**—It is coming to the committee because Senator Sherry has asked for it. We will provide it.

**CHAIR**—What about superannuation products? We can understand that your sophisticated 10 per cent of the market can read a prospectus and can understand this—it may be a trail case—but we have had fellows who have come in with a lump sum, no matter how it has been acquired, which they want to put into superannuation.

**Mr Gilbert**—This is post-SG—a lump sum going into a retirement stream?

**CHAIR**—Yes.

**Mr Gilbert**—Depending on the product, they can elect to have an up-front fee or to pay a flat fee and not have trail—they can dial the trail down—but they do not want to. Many of them prefer to have the fee deducted from the capital on an ongoing basis.

**CHAIR**—Yes, but it does make it more difficult to compare fees if you have some with trail commissions and some without trail commissions.

**Mr Gilbert**—If you have a large lump sum, that is why you go to a financial planner and get them to do the figures for you as part of the proposition.

**Senator SHERRY**—What would be a large lump sum?

**Mr Gilbert**—I do not want to be giving financial advice here, but I would imagine that you would be talking about a couple of hundred thousand or \$100,000. Bill probably knows more about what a person does with \$100,000.

**CHAIR**—How about we say people who have amounts of less than \$50,000 for investment with no trail commissions?

**Mr Gilbert**—If they have only got \$50,000 they are probably going to be paying their mortgage off or putting it in the bank.

**Senator SHERRY**—I have to say that people have come in to me with \$20,000. They bring in the documentation from the financial planner, which is often 100 pages long.

**Mr Gilbert**—On that one, the financial planner has a legal obligation to know his or her client. If that person is getting advice to have \$20,000 whittled away by fees then I think that the fixed scheme is the place for them to go.

**Senator SHERRY**—I had someone in my office last Friday and I said to him, ‘Did you understand this material?’ All of the material is there—

**Mr Gilbert**—He went to a planner?

**Senator SHERRY**—Yes. He had all of the material there, but he did not understand it. He got his lump sum—his cheque—and he thought he had to do something so he went off to the financial planner. But he did not understand it.

**Mr Gilbert**—That is what the fixed scheme is there for. Without knowing the details, I am sure they would settle disputes like that. But to put a limit—

**Senator SHERRY**—Yes, the fixed scheme is there. The problem is that it requires an individual to be proactive and to go through a semi-legal process—

**Mr Gilbert**—At no cost.

**Senator SHERRY**—Yes, but it still requires them to do that. The reality is that a lot of people do not feel that they can go through that type of process. Shouldn’t we be ensuring that it does not happen, full stop?

**Mr Gilbert**—When you have a benchmark or a limit, which is what Senator Watson is suggesting, you prevent the behaviour all the way to that limit, but after that what do you do? I think that the principle of knowing your client and giving good advice is a much better safeguard to the individual you are referring to.

**CHAIR**—But that is there anyway. It is still there.

**Mr Gilbert**—Yes, but if you put a limit there and then somebody does it for one more dollar, they have a case to say, ‘I am outside the law here.’ I do not think it is a very sensible direction to move in.

**CHAIR**—We are out to protect those people who are the most vulnerable in society.

**Mr Gilbert**—That might be the case, but we need more than anecdotal evidence. We should be doing the research. We need to do the research and this committee probably needs to do more research than three or four anecdotes. I think the financial planners may well be able to help you on that front.

**Senator SHERRY**—I agree with you. Your organisation has done a reasonable survey—I congratulated you at the time. ASFA has done it and Bateman has done it also. One of the critical things is that an independent statutory government authority does not have this

information. It seems to me that logically they should have it so that we can determine the real level of the problem.

**Mr Gilbert**—I would just like to say that we do not represent the people giving advice; we design the products and deal in them. So I think I have probably given the committee a fair exposition on what my knowledge is. I hope I have satisfied you, Senator Buckland. Did I cut you off with the answer I gave? Did you want any more information?

**Senator BUCKLAND**—No, I probably would have only got cranky so you probably did the committee a service.

**Mr Gilbert**—I am very happy to brief you on the various types of products. It is very hard—in any industry you will find there is a range of products at a different price. In some respects that is better than having one product at one price. Some people have suggested that we have a cap on fees. Let me tell you that capping fees will be like having bank interest rates at 13.5 per cent. There was a limit on bank interest rates back in the eighties or whenever it was, and what was the interest rate? It was 13.5 per cent. To some extent we have a deeming rate, so what do banks pay to people who want to put money into those accounts? They pay them the deeming rate—there is no competition above or below.

**Senator SHERRY**—We have a cap on health insurance fees regulated by government and a cap on aged care fees regulated by government.

**Mr Gilbert**—And what are the rates? They are very close to each other.

**Senator SHERRY**—Yes.

**Mr Gilbert**—We are living in a fairly sophisticated consumer society. I think that individuals need to be able to select from a variety of prices and services.

**CHAIR**—In terms of the higher income earners and high wealth individuals, you will have to wait for the report. I am very pleased about your comments in relation to integration, because it is close to my heart. I will read it out—it says that you support:

... the development of a simple, transparent long-term savings vehicle with tax benefits as an adjunct to superannuation. Purposes could include reduced employment income, parenting, or loss of employment. The preservation arrangements make super an inappropriate vehicle for other long term savings. The only other useful vehicle in existence appears to be mortgage redraw facilities.

Do you have any specific design features in mind for products of this type? Secondly, what are the implications of the current high levels of household debt on the ability of people to save, or even to make personal super contributions? I just wanted to introduce a couple more topics before we leave.

**Mr Stanhope**—Part of the outworkings of compulsory superannuation has been that there is only one market product, if you like, for people to save in that has been around for any length of time and that is insurance bonds. The point we made in our submission was that, whilst investment performance and all of those things can be seen, it is very hard for an individual to work out what they actually have out of those because the tax on them can be quite uncertain; it

is no less until you have been in for 10 years. Most other jurisdictions have a tax preferred savings vehicle that is pretty simple in design. It allows people to do medium term savings for needs like shifting money from reasonably high double incomes to reasonably low single incomes and fractious life as young parents, say, for the education of their children.

All of those sorts of objectives are not well covered by the superannuation system—nor is the prospect of losing your employment. One of the smaller outworkings of the change to preservation in 1999 was that, up until that time, if you put undeducted contributions into superannuation and you lost your job you could at least take them and talk to your bank manager about keeping your mortgage. One of the points that Senator Sherry has often made about the amount of money coming out on early release is that you cannot now withdraw new undeducted contributions. Some of the small safety valves that existed in the superannuation system have been closed and there is no other vehicle for doing those things, except to pay money into a redraw mortgage.

An interesting analysis was done in the 1980s. It was done as part of arguing that superannuation should be available for housing deposits, which I do not think much of the industry supports. The interesting analysis was that, if you looked at household gearing since the deregulation of personal finance in 1991 and you looked at the super guarantee, if you get the scales right you can whack those two curves one on top of the other. It does not show you that there has been a causal relationship—because while average balances are below \$5,000 you cannot really argue that people are making mortgage decisions based on what little they have got in super—but you can certainly see that people have been changing their behaviour on their mortgages at the same time as they have been going into superannuation saving. We are suggesting here that it is worth looking at those, and it is certainly worth thinking about providing a simple, tax preferred vehicle for long-term savings. Every other jurisdiction has one, but Australia really does not; not in that simple, transparent sense, with tax certainty.

**CHAIR**—What are they called in the United States and in Britain?

**Mr Stanhope**—We could provide you with that information. They have a variety of acronyms—usually fairly clever. There is a scheme for procrastinators in the States which has a great name which I can never recall, and there is a scheme for natural savers. They are both fairly cleverly named.

**Senator SHERRY**—Natural savers—is that an ethical investment!

**Mr Stanhope**—We found natural savers in our research. A proportion of the population are natural wealth accumulators.

**Senator SHERRY**—I know what you mean.

**Mr Stanhope**—Simple retirement savings products are available in Canada which have some interesting prospects. For example, you cannot be in managed investments once you leave the country. They are not necessarily completely comparable, but we do not have them in Australia. A number of commentators have suggested that it is occurring by stealth in redraw mortgages; that is fine if you are lucky enough to have a mortgage.

**Senator SHERRY**—And we say it is probably occurring by stealth in terms of early access to super.

**Mr Stanhope**—That is a point that you have made. While you were out of the room I made the comment about the change to preservation in 1999 and what the outworkings of that might be. We really are lacking a medium to long-term savings vehicle.

**CHAIR**—How do we design educational material for people who are financially illiterate and when should this education be commenced? Should we wait until the current superannuation regime has been reviewed and, hopefully, simplified? This is a big issue. My colleague Senator Sherry keeps raising it.

**Mr Stanhope**—One of the most important considerations in that question is to distinguish between education and advice.

**CHAIR**—No, we are talking about education.

**Mr Stanhope**—I realise that but there have been proposals put on the table to provide advice, which is a very different creature and carries liability that is entirely different. So let us be clear: we are talking about education. There are a number of services that provide that. Probably the largest mass service that provides that in Australia is Centrelink's Financial Information Service, which runs a raft of seminars, as you are probably aware. There is also a small organisation that runs on the smell of a budget oily rag called the National Information Centre on Retirement Investments, which produces information for people saving for their retirement and for retirees.

**Senator SHERRY**—Is that a government organisation?

**Mr Stanhope**—Yes. They produce material for Centrelink's Financial Information Service. They also write the copy for a Commonwealth publication called *Investing money – your choices*. One of the interesting things that they find is that a publication like that—which is 84 A4 pages—is so daunting to some people saving for their retirement that they say, 'Please, I do not want that. Can you give me that single A4 sheet that describes the one particular investment? That is all I can manage.' So we are at the point where not only do we not have education, widely, for this, we have people who are frightened of the information itself and want to digest it in small amounts.

It is a large question. We have thought about it in the context of the superannuation choice campaign given the proposals for advice that were around. But, again, how do you deliver it? The point at which people are interested in financial information is the point at which they are making a decision and, in some cases, what they need is a mix of information and advice. A highly-trained professional—so that the tier 1 standards in ASIC's policy statement 146 are complied with—is a very expensive person to provide basic financial education. They would be a good person to provide advice—and that is what the standard is there for—but it is a very expensive way to provide education. We need to talk about how that happens because people are receptive to that information at very different times in their lives.

**Mr Gilbert**—I refer back to the scheme that we have now which has government and consumer appointees and is funded by the industry. One of the things that perhaps the committee could think about is a scheme that has industry and government representatives on it and which is cofunded by industry and government. It would not necessarily be funded by all of my members. The other sectors, such as the industry funds and the corporates, could be working on that and we could have a very efficient and effective method of providing some mass materials which help people who have trouble with numeracy.

**Mr Stanhope**—Let me say that in the evaluations of those various services that I mentioned there is one clear equation that comes out and that is, even though they may not be knowledgeable, consumers are very concerned about credibility. When you look at the evaluation, that is clearly a product of two things. One is competence—knowing what you are talking about—but the other is independence. People will clearly discount heavily any advice they see as coming from somebody with an axe to grind. So, for example, in Centrelink's Financial Information Service seminars you will find that somebody who comes from a commercial organisation, but speaks independently and does not push a product, gets credibility. But someone in a seminar that is badged, say, by one of our providers—and our member companies do a lot of education work—is discounted by people, somewhat. As Richard points out, the challenge is to provide that in an environment which is clearly seen to be independent of us. One of the reasons that we have given significant verbal support to NICRI over the years is precisely because they are independent.

**CHAIR**—You talk about unnecessary and counterproductive rigidities in transition from work to retirement. I put this question to you: if all work and age based tests were removed, how would we deal with the fact or perception of any potential for estate planning?

**Mr Stanhope**—I think estate planning is a slightly separate issue than rigidities in the transition from work to retirement. Nobody is disputing that the concessions in superannuation and retirement income and, most particularly, the tax exemption on—

**CHAIR**—I want to satisfy myself that, if we reduce or take away all of these rigidities, such as work and age based tests, we are not just going to open up a Pandora's box for estate planning.

**Mr Stanhope**—We are not proposing that age based tests be taken away, simply that they be a little more flexible. Quite clearly—as the design of growth pension reflects—we are not interested in creating concessions for the building of estates.

**Mr Gilbert**—In relation to the growth pension, the balance on that fund at life expectancy is zero, whereas, with an allocated pension, if you take the minimum draw-down you can actually have a whole lot of tax-referred money for your estate.

**Mr Stanhope**—To go back to your question, the problem that we really have is that the work-to-retirement transition is essentially designed around somebody who works their whole life in one job, probably is male, and retires once, on a day they know in advance. I guess you might know that day, if it is an election day!

**Senator CHAPMAN**—What was the—

**Mr Stanhope**—The presumption is that people retire once.

**Senator CHAPMAN**—Don't raise—

**Mr Stanhope**—You know I used to run your fund!

**Senator CHAPMAN**—So did someone else I know.

**Senator SHERRY**—Someone sitting very close to you.

**Mr Stanhope**—The point here is that one of the rigidities was just removed by the Assistant Treasurer, and that was the problem with internal rollovers in funds; but, for example, once you start an income stream, you cannot turn it off. In that example, the draw-down factors in an allocated product will ensure, or ought to ensure, that you do not get moneys going inappropriately to an estate. Clearly, retirees are not willing to trade their own hard-earned into longevity risk. One of the things that came up very strongly in our research, and comes up very strongly in the market, is that they like the idea of longevity risk until they come up with the cost, and then—as another paper presented to our conference last week argued—perhaps they achieve that through the age pension itself.

If you remove the rigidities but get the products right, you ought to get the right sorts of draw-down of capital anyway. We are not arguing against that. We are simply saying that we have a raft of rules which people find incomprehensible and some of which are simply expensive for funds to administer, and find their way into fees. One of those is the monitoring of employment status after age 65. Despite a number of committees, including a House of Representatives committee, suggesting that that ought to be removed, we are still in the process of discussing how that is going to occur. We expected to see it in the budget package and we provided submissions there, but we still have not seen it. So there are a raft of those things.

There is also one large slab of research into the circumstances of older workers which is in the hands of the Department of Family and Community Services. Some of that has been released publicly; some of that they are still in the process of looking at. That will be one of the few pieces of large sample research—there are 5,000 people in that sample—that tells us what is actually occurring. Often we are guessing and, as you know, individual super funds only know the money that sits in their fund. They do not know the other circumstances, the balances or assets, of people. Only financial planners and the individual would know that.

Again, we are talking about a set of rules that allows people to experience what happens to them between, say, age 55, or their preservation age, and whatever age we say they should be completely into superannuation by. Perhaps that is 75 with increasing longevity. It may need to go out further than that. It is certainly only up to 65 and a little bit to 70 with tax-deductible contributions. You are not so worried about revenue after if you have an undeducted contribution going into superannuation. There are a lot of things being considered in that area. We have a number of suggestions and we are working them through but, frankly, our program has been just a little derailed by the amount of changed legislation going through at the moment.

**Senator SHERRY**—There are four bills and another 200 pages at my count! Perhaps the committee could request the department to provide us with that research that Mr Stanhope referred to. I think it would be useful for us.

**Mr Stanhope**—They have a number of public fact sheets.

**Senator SHERRY**—I would also like to ask for the non-public stuff.

**CHAIR**—No problem. Given ASFA's preference for whole-of-life equity measures, do you have a view on the surcharge? For example, do you consider that it should be removed? If so, how should that revenue shortfall be filled?

**Senator SHERRY**—I thought we dealt with this at the last hearing. I was not even going to raise it.

**Mr Gilbert**—At that last meeting, we said that we supported the gradual phasing out of the surcharge, for a variety of reasons. I am prepared to elaborate on those again if the committee would like me to.

**Senator SHERRY**—Are you able to respond to that question I put about the proportion of people in that fund you identified who—

**Mr Gilbert**—What the average balance was?

**Senator SHERRY**—Yes, who were not at surchargeable—

**Mr Gilbert**—We have been trying to get that information. Mr Stanhope might have it.

**Mr Stanhope**—We only have it vaguely. Remember, that is quite a large fund. The fund manager thinks that the average age of members is between 50 and 55—nobody wanted to put it any closer than that—and the average balance is between \$20,000 and \$30,000. The reason for that uncertainty is that that particular fund has a lot of legacy accounts which are small, so they tends to skew the fund a bit.

**Mr Gilbert**—I think the figure we gave you for the average surchargeable balance was 50.

**CHAIR**—It was 50 or 60.

**Mr Stanhope**—The median surchargeable balance was 50.

**CHAIR**—That was very useful.

**Mr Gilbert**—That balance is actually in that one. We were not able to split it out.

**Senator SHERRY**—If you could do that on notice.

**Mr Stanhope**—We will be sending those to you.

**CHAIR**—We have also got to look at this question about front-end taxes. Everybody seems to be in favour of reducing them.

**Senator SHERRY**—Hear, hear!

**CHAIR**—How can the revenue shortfall be filled? Or do you believe there are other measures which can provide greater equity to the lower-income earner than an across-the-board reduction in a contribution tax? Should we be attempting to target the poorer in the community more, rather than providing everybody with a lower level of contribution tax?

**Mr Stanhope**—The main thing that we suggested on the removal of front-end taxes was that it be gradual to allow adjustment for the reliance of Commonwealth revenue on those taxes. A number of other suggestions have been made, on which we are relatively agnostic. As far as I can recall, one is to fix the proportion in real terms, otherwise those taxes will rise as a proportion of GDP over time.

**Mr Gilbert**—But, honestly, there is no magic honey pot here. It is a matter of a government deciding that this a high priority area. That is why we applauded the government when it introduced its package of reductions in front-end taxes during the election, and why we have conveyed to the opposition that their decision to get additional funds to the superannuation savings agenda is also a positive step. It is about opportunity costs.

**Mr Stanhope**—Our research into voluntary contributions shows that you can use reasonably creative thinking in that third pillar of retirement incomes to bolster saving at the lower end. We found quite significant levels of willingness of response to a co-contribution. The interesting thing that we found was that a co-contribution at 50c for a dollar contributed was almost the same as the contribution for a dollar for dollar contributed. For a government scheme which, as you might remember, we costed at \$134 million, we show that you could, for not so terribly much more money—that is around the \$200 million figure; and bear in mind that this work is still in progress—you could do \$1 for \$2 up to \$40,000. You could really hit that mass of middle incomes, phasing it out above \$40,000, and still get a whack that, I think, total contributions would be \$371 million extra into superannuation annually. So the bang that you get for the buck in voluntary contributions is quite significant, and we can leverage it further by going to \$1 for \$2 in terms of Commonwealth—

**CHAIR**—What about very low-income earners—under \$24,000 a year? What about the concept of direct government grants into their superannuation funds, rather than an across-the-board cut? Some people are suggesting that we should put the tax up to 20 per cent and then provide a greater government discretion for the low incomes.

**Senator SHERRY**—Who is suggesting that?

**CHAIR**—I do not know where it comes from.

**Mr Stanhope**—A certain venerable economic commentator suggested that not so long ago.

**Senator SHERRY**—I am shocked that anyone would suggest that.

**Mr Gilbert**—We had some data on that the other day.

**CHAIR**—We have to try to get the balance correct, though.

**Mr Stanhope**—In terms of the third pillar of voluntary saving, we certainly found that responses to co-contributions were still reasonably good even below \$20,000. From \$10,000 to \$20,000, we found that 28 per cent of people said they would contribute if the scheme was dollar for dollar and 22 per cent said that they would contribute if it was 50 cents for a dollar. So there are certainly people who are prepared to contribute. Bear in mind that once you get down below half average weekly earnings, and certainly below quarter average weekly earnings, the replacement rates that you are talking about in the age pension can in fact be higher than 100 per cent.

**Senator SHERRY**—For a half, that is about \$20,000, isn't it?

**Mr Stanhope**—For average weekly earnings, it is about \$44,000.

**CHAIR**—Are there any other questions from the committee? We are slightly over of time.

**Senator SHERRY**—It is always useful.

**Mr Gilbert**—Thank you for your questions on growth pensions. That was appreciated.

**Senator SHERRY**—Should we congratulate Mr Gilbert on his appointment?

**CHAIR**—We have.

**Mr Gilbert**—Thank you very much.

[4.01 p.m.]

**BROWN, Mr Roger, Senior Manager, Rehabilitation and Enforcement, Australian Prudential Regulation Authority**

**BRUNNER, Mr Greg, General Manager, Policy Development and Statistics, Australian Prudential Regulation Authority**

**ROBERTS, Dr Darryl, General Manager, Central Region, Australian Prudential Regulation Authority**

**VENKATRAMANI, Mr Senthamangalam, General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority**

**CHAIR**—Do you have any comments to make on the capacity in which you appear?

**Mr Venkatramani**—I am also the chair of the internal group on superannuation within APRA.

**CHAIR**—I had a question asked of me this morning about the rationale for prohibition of people transferring productive assets like rented properties from their personal ownership into their superannuation fund. What is the rationale for that? Is that relevant nowadays, given the taking away of the work test and all that sort of thing? Dr Roberts, you were there at the beginning. Do we really need that nowadays? Somebody wanted to transfer it, they were young, and they said: ‘Why should we have to sell our asset and get cash or buy another property? My husband is a builder and we believe that this might even be inferior to what we want to transfer from our joint names into our superannuation. We are not retired.’

**Dr Roberts**—I will have a go at answering that and my colleagues might want to add their comments.

**CHAIR**—In terms of changing legislation, have we now reached the stage when the original purpose for having it there has changed?

**Dr Roberts**—I think there have always been concerns about member-directed investments. We have always tried to encourage conventional investment strategies where all of the members of a fund are offered a choice of strategy.

**CHAIR**—I am talking about essentially do-it-yourself, the small people at the bottom end of the market.

**Dr Roberts**—Certainly some people have the view that they want to nominate their own assets and manage them. They should structure themselves to go to the tax office.

**CHAIR**—All right, they should go to the tax office. But we have got this legislative prohibition. I am not talking about people who have employees in the fund or anything like that but where all the trustees are members. Why should we have that prohibition there?

**Dr Roberts**—I am not aware that there is one for self-managed funds or even for APRA funds—

**CHAIR**—But there is a law there. The same law applies whether it is an APRA fund or a tax fund, doesn't it?

**Mr Venkatramani**—I think there is a difference between self-managed super funds and small APRA funds. In relation to self-managed super funds, the law, as it is, does allow real property to be transferred—that kind of in specie contribution is allowed. In relation to—

**CHAIR**—Are you saying it can be?

**Mr Venkatramani**—It can be. At this point in time, in specie contribution is allowed in respect of real property in respect of self-managed funds. For ATO funds, you can transfer real business property.

**CHAIR**—That was a change that was made when there was a transfer from APRA to the tax office.

**Mr Venkatramani**—That is right. The existing test was, if you like, made more liberal. Earlier, I think it was something like 40 per cent; now you can transfer real business property to the extent of 100 per cent.

**Dr Roberts**—We also have some small APRA funds where, I think, if people get the advice of a financial planner, the funds may allow them to nominate assets, but we do not generally regard that as good practice.

**CHAIR**—As long as they meet the diversity test. They still have to have some diversity.

**Dr Roberts**—If they are an APRA fund, we would far prefer that they had the choice of an investment strategy, but not the choice of individual assets, because our experience is that having individual assets leads to illiquidity, lumpiness, and exotic assets in a number of cases have proved unsuitable.

**CHAIR**—My case is very straightforward. You have now confirmed to me today that, in terms of a tax fund, my constituent can actually transfer a couple of rented properties from his or her name, or joint names, to the superannuation fund.

**Mr Venkatramani**—Business real property. It has to be business related; it cannot be a residential property; it has to be a business premise. That is what the law allows today.

**CHAIR**—They have, I think, rented houses or something like that.

**Mr Venkatramani**—I do not think that would be captured under the current stipulation, Senator. Let us go back to the rationale, though. Our system—

**CHAIR**—I know you can transfer an office complex; we passed that legislation some time ago—

**Mr Venkatramani**—That is right.

**CHAIR**—But we have a situation where agents are collecting the rents et cetera. The property in their super fund includes three of these properties but, during their lives, they felt that they did not really want to tie it up in superannuation, so they put the properties into their own names—built them and put them in their own names. The time has now come when they say, ‘We want to put these assets, these rented properties, into a superannuation fund.’ Initially, you told me that it was okay; now you are putting qualifications on it.

**Mr Venkatramani**—No, I am saying ‘business real property’. That is the phrase which, I believe, is used in the law.

**CHAIR**—What do you call ‘business real property’?

**Mr Venkatramani**—It has to be used for the purpose of the business.

**CHAIR**—Their business?

**Mr Venkatramani**—Yes, that is correct. For someone like a lawyer or an engineer who has his own practice or an office, the law, as it is, allows them to put that property—

**CHAIR**—Absolutely. So, in a sense, even though it might be non-residential, you cannot put that into your superannuation fund if it is a tax fund?

**Mr Venkatramani**—Yes, that is my understanding.

**CHAIR**—That confirms my earlier advice.

**Mr Venkatramani**—If you are talking about the rationale—to add to what Darryl just said—our system was founded on the premise that a bunch of trustees are responsible for managing these long-term savings. There is also a provision in the superannuation law that a trustee cannot be directed by anyone as to what to do.

**CHAIR**—Absolutely.

**Mr Venkatramani**—These principles go together, I think, in trying to structure a portfolio which will be appropriately balanced over a long time. The greater say we give to individual members as to what the trustee should do, to that extent, it has the likely impact of skewing that portfolio’s balance. I think that was the rationale, if you like.

**CHAIR**—So now that we are quite clear on what is in and what is out, what is the rationale for disallowing that transfer?

**Dr Roberts**—It is the intermixing of your personal circumstances with the fund.

**CHAIR**—No, we can completely transfer them—the title and everything go into the super fund.

**Dr Roberts**—A self-managed fund of a tax office could, from a starting point, buy a residential property and let it. But to take a property from the members, to purchase assets from the members, has always been regarded as a conflict of interest between the personal fortunes of the members and their retirement incomes.

**CHAIR**—Can you see the problem? They have a good asset that they have now been told they have to sell but, if they want to put it into property, they have to go out and buy another property. That seems a bit ridiculous.

**Dr Roberts**—The fund and the members' personal circumstances have some separation between them.

**CHAIR**—Yes.

**Senator CHAPMAN**—I have missed something; why do they have to sell it?

**CHAIR**—They want to put it into their super fund, because the law requires them to. They cannot transfer it without selling it.

**Senator CHAPMAN**—Why would they put it into a super fund?

**CHAIR**—There are a whole lot of tax reasons, for example .

**Senator CHAPMAN**—But that is a capital gains tax event if they do that, isn't it?

**Mr Venkatramani**—It would still trigger a tax event. Even if it were allowed, there would be a capital gains tax.

**CHAIR**—Yes, but they are prepared to pay all those things.

**Senator CHAPMAN**—Yes, but there is no gain from that.

**CHAIR**—I just want to work out what the rationale is for stopping it. That is my question to you.

**Mr Venkatramani**—One of the real problems is the valuation, particularly if they are not publicly quoted things like listed shares et cetera. You could get into a lot of problems with what is the actual value. As you know, super requires market valuation for most reporting entities. So there would be real problems if you are talking about lumpy assets like property.

**Dr Roberts**—It is more of a retirement income requirement than a safety requirement. I think it flows from the sole purpose test in that the requirements of the sole purpose test say that superannuation should be used for ultimate retirement and, therefore, it is preserved until you retire. Also, the fund should not be buying and selling assets with its membership, because you get an intermixing of the personal circumstances of the member and the retirement purposes of the fund.

**CHAIR**—Thank you for that answer; we get a lot of these sorts of questions. Confidence in the superannuation system is very important. I invite you to make your opening statement.

**Mr Venkatramani**—We would like to briefly comment on one key issue in relation to super safety: the interaction between the SIS regulatory framework on the one hand and APRA's ongoing supervision on the other, in order to make the point that, in our view, supervision without robust law reform is inadequate for the degree of protection the community seems to demand.

A prudential regulator has two sets of tools: firstly, regulation in the form of licensing conditions, capital requirements, government standards and enforcement powers. Other regulation is codified in the SIS legislation. Secondly, there is supervision in the form of regular financial analysis, on-site inspections, intelligence gathering and enforcement action. In Australia superannuation supervision is made harder by the fragmentation and range of sophistication in the industry. These two sets of tools are used in combination. Regulation without adequate supervision is a forlorn hope; supervision without adequate regulation is a toothless tiger.

APRA has been progressively upgrading its ongoing supervision of the industry and made around 1,200 on-site inspections last year. This will rise to something like 1,400 in future years, allowing super funds to be visited on average once a year for major funds and, on average, once every two years for others. We are achieving some good outcomes with the enhancements to our enforcement powers that were recently enacted by parliament, for example, the introduction of enforceable undertakings and the shift from fault liability to strict liability in respect of some breaches. We have been taking a much tougher line with late lodgments of annual returns and developing a substantial upgrade of the financial reporting system. That is due for introduction in time for the 2003 returns. The benefits of expanded supervision activity will be limited, however, if there are major gaps in the regulatory framework, and in particular the lack of standards making power and a licensing power.

A standards making power would give APRA the flexibility to adjust the prudential requirements to reflect industry developments and regulatory trends, without the need to undertake the complex and often slow processes required to amend the legislation. The APRA standards, we reiterate, would still be subject to industry consultation and parliamentary approval. In regard to a licensing power, the SI(S) Act currently requires licensing for approved trustees offering retail super to the general public, but not for trustees managing standard employer super for particular workplace and industry groups. APRA has proposed licensing for the second group as well, and this proposal is currently under consideration by a government working group.

While any decision on SIS reforms of course is a matter for the government, it is widely known that APRA regards licensing as a key missing ingredient in its regulatory tool kit. Licensing allows unsuitable parties to be kept out of the industry in the first instance and industry players to be appropriately constrained by formal conditions in the second. Our CEO, Mr Graeme Thompson, recently indicated publicly that around 10 per cent of employer sponsored super funds might fail to pass a licensing test were one to be introduced. We would like to give some context to this figure, while also noting that such figuring can only be very approximate at this stage because the structure of the superannuation industry is constantly changing.

APRA currently regulates around 2,500 employer sponsored super funds, including some 1,700 small to medium funds with assets under \$10 million each, of which 800 funds would have assets under \$1 million each. This segment has been contracting steadily as a result of market pressures and regulatory requirements, with members shifting to larger funds or self-managed funds. Another 200 funds are currently scheduled to exit.

In APRA's experience, at any one time about 150 small to medium funds have serious weaknesses warranting close surveillance and possibly active enforcement. The kind of weaknesses we find typically are: investment strategies involving speculation and leverage; lumpy and illiquid investment portfolios; excessive in-house assets; related party transactions involving conflicts of interest; non-lodgment or late lodgment of annual returns; shoddy record keeping; defined benefit funds in deficit; breaches of equal representation; and lack of effective control over service providers.

Another 150 or so funds managing less than \$1 million would arguably be too small to satisfy the minimum requirements of a prudent licensing test. The exact numbers will depend upon how high the entry bar is set and how willing are marginal funds to upgrade their resources and systems. As a result, the introduction of a licensing test might, in APRA's view, see some 300 or so small or problematic funds exit the industry, and this would do much to improve the overall safety of the industry. It should be noted, however, that these are our views as regulators, not the government's, and indeed no government decision has been made to introduce licensing for employer sponsored funds at this stage.

**CHAIR**—Do you have a copy of that? There are some far-reaching issues in that which we need to have a look at.

**Mr Venkatramani**—I can send you one electronically, if that would be easier.

**CHAIR**—We really need to be able to ask you questions at the moment, because there is a very wide scope there and some pretty heavy items.

**Senator HOGG**—Before we do, could I just ask a question of clarification. In respect of the visitations you spoke about—once per year to major funds and once every two years to others—can you categorise what you put in the basket of 'major' and what you put in the basket of 'others'? Later on you talk about small to medium funds and funds with less than \$1 million and so on, and I am just trying to relate that back.

**Dr Roberts**—It is not strictly a size difference. We have an internal risk rating system in APRA for all our regulated entities. We are currently in the process of upgrading that internal

risk rating system, and our visit strategies—our on-site inspection schedules—are based on risk rating.

**Senator HOGG**—Not on size.

**Dr Roberts**—To some extent it would be true to say that the larger ones get visited once a year, because our risk rating system will now take account of the impact of failure as well as the probability of failure. Large institutions, even if they are well run in our view, will constitute a threat simply because of their size. To some extent there would be a size thing. Larger entities would tend to be visited annually and smaller ones every two years. But, because of the risk rating system, if a smaller fund has particular issues, it could be categorised as a major problem and therefore subject to more frequent visits.

**Senator HOGG**—Even those that are in the low risk category will still be visited once every two years. There is nothing worse than that?

**Dr Roberts**—At least.

**Senator HOGG**—Does that relate, in any way, to the other information you gave us about funds?

**Dr Roberts**—No.

**Senator SHERRY**—Could I raise an issue about an individual fund?

**CHAIR**—Can we just follow the problem of this statement through.

**Senator SHERRY**—Could we have a copy of this statement?

**CHAIR**—It is coming.

**Senator SHERRY**—I know it is coming. It would be useful.

**CHAIR**—Looking at the newspaper cuttings about the so-called crisis that, unfortunately, has tagged the whole industry, from my perspective, it was a little bit unfortunate because it came at a time associated with some negative returns. There is hardly a dinner table or bar conversation now that does not address this question of confidence in superannuation.

**Dr Roberts**—We did not use the term ‘crisis’.

**CHAIR**—No, but that is how it has been interpreted, unfortunately, in a number of publications.

**Senator SHERRY**—When you say 150 funds are under close supervision—

**CHAIR**—For example, the respected *Financial Review*, on Tuesday, 9 July, uses the term in their headline: ‘Super industry denies crisis’.

**Dr Roberts**—We are not responsible for that.

**CHAIR**—I know, but we have to be very careful. All the people participating in this debate have to express a degree of confidence. You always have people, in any system, who do not meet the criteria for one reason or another. The regulator is there to pick those people up and to take appropriate action. But I have to counsel against this sort of publicity because I do not think it assists the industry at all, particularly as it has not come at a time of high returns; it has come at a time of low returns. The anecdotal evidence is that people are really worried about their future. One of the good measures of Senator Coonan's announcement about meeting 90 per cent of the CNAL was that it restored that degree of confidence, because people are increasingly saying, 'At least if I had my money in a bank account it would not reduce in value.' They only see the downside of it at the present time. That is the problem. I have got to use this opportunity to express caution against similar announcements. You obviously had good reasons for doing it, and, as the minister said, some people do need a wakeup call. That is probably best coming directly from you to them, so that they realise that they should be moving to a bigger trustee that can more easily meet your demands. Would you like to respond to that?

**Mr Brown**—We need to clarify that the role of a prudential regulator is to oversee the entities within an industry in a forward-looking way to seek to prevent failure rather than to come in afterwards to pick up the pieces. When we talk about funds exiting the industry and the desirability of that in some circumstances, it is because we have the view that some funds towards the bottom end of the industry do not have and will not be able to have the structures and processes in place to give a high level of security going forward.

We can also put into that equation a different perspective as to the actual losses within the industry over a period of time. This is an issue that I have been following for some 15 years. If we take losses due to fraud alone, my best estimate of total losses in the industry over a 15-year period is only \$90 million in what is now a \$540 billion industry. Those are all the instances of fraud that I have been able to identify. We are talking 0.017 per cent of current fund assets.

**CHAIR**—Let us get that clear. Although there might have been fraud, it might not have had a significant impact upon a person's life, like the CNAL cash management trust. We can have various levels of fraud. Yes, there might be fraud, but the fund can still carry it, in a sense—we have the press here; that is why we have to be careful about how we use the term 'fraud'—so that might not necessarily be a complete loss.

**Mr Brown**—That is correct. In some of the instances that go into that figure the loss has been made up, either by an employer sponsor or by a superannuation fund trustee, so there has not been actual loss to the member in some of those instances. By the same token, we cannot afford to belittle this figure—

**CHAIR**—We cannot ignore it—absolutely.

**Mr Brown**—because for some people who have lost their life savings it is devastating. We can say that, in the context of the industry, it has been tiny; for individuals it can be profound.

**Dr Roberts**—You have drawn attention in the past to some results that have been not so good, like CNAL, EPAS and so on, so APRA has been very consciously trying to upgrade its

performance. That is why Mr Venkatramani's statement emphasised the two elements to this: the regulatory powers and the way we use them on an ongoing basis. Over the life of SIS we have always said that four to five per cent of funds tend to have hard-core problems, but they do not always necessarily lead to losses. The community expects us to do better each year in pushing that number down, so that is what we are trying to emphasise.

**CHAIR**—When I was in Queensland last week I was informed that APRA had taken legal action against three funds there that we have had concerns about. Can you confirm that?

**Dr Roberts**—Was that in relation to late returns?

**CHAIR**—No, it was in relation to fundamental problems that some funds have had.

**Senator SHERRY**—That would be EPAS, the hairdressers and the law funds, wouldn't it?

**CHAIR**—They were the ones.

**Dr Roberts**—We would have to take that on notice.

**CHAIR**—I understand you are taking disciplinary action. Is that right?

**Mr Brown**—I am aware of ASIC taking action—

**CHAIR**—It might be ASIC taking action.

**Mr Brown**—Yes, it should be ASIC.

**Mr Venkatramani**—Even then, there is close cooperation between our two agencies. Sometimes, depending on the legal provisions, we decide who would be best placed to take action. Some of the ASIC regulations, in terms of disclosure et cetera, are much more susceptible to immediate legal action, so it could well be ASIC.

**Mr Brown**—There have been a number of instances where ASIC have taken action on the basis of a referral from APRA, where we have identified issues, realised that the relevant provisions are those administered by ASIC, and simply made the referral.

**CHAIR**—This committee drew people's attention to this issue quite some time ago, so we are pleased that one of the regulators has certainly taken action.

**Mr Venkatramani**—Senator, I would like to make one particular point about the very important point you made. Whilst we need to deal with these problems as they arise from time to time, we need also to focus on the positive message that it is a very large industry which, by and large, is extremely well managed. We do try to provide that. Unfortunately, from our perspective, whatever news comes out, for secrecy obligations, is more likely to be bad news than good news. At any point in time, we are dealing with a whole range of funds at various stages of issues, and most of the time we are able to successfully manage those issues well. Because of the secrecy obligations, no-one will talk about it. We cannot talk about it, the individual funds will

not talk about it and the press will not know about it. If the problem were known, it is highly unlikely to be newsworthy anyway. Therefore, the issue is that, at any point in time, a lot of good work is done and the problem is solved—end of story. We do try and focus on that whenever we talk about problems in institutions—that, by and large, it is a very responsibly and well managed industry.

**Senator SHERRY**—Can I raise an issue?

**CHAIR**—Before you do that, while we are on this issue, I would like to congratulate you on upgrading your superannuation and on taking on additional people.

**Senator SHERRY**—I do not know whether you are aware that there was a discussion on the John Laws show this morning. Are you aware of that?

**Mr Venkatramani**—Yes.

**Senator SHERRY**—I thought you might be. A concerned former Ansett employee rang in. I caught only the end of the conversation; I did not catch the whole conversation. They were concerned about the payout from Ansett's superannuation funds. I think there were a few funds. Can you give us an update on what the problem is? Is there a time frame? What is happening? I think there are many former Ansett employees who are caught up in this problem.

**Dr Roberts**—I have a short statement. I will give a copy to you.

**Senator SHERRY**—I am sure John Laws would be impressed.

**CHAIR**—Can we accept that as a tabled document?

**Dr Roberts**—I would like to read it, if I could.

**CHAIR**—Yes, that would be good.

**Dr Roberts**—Both APRA and the trustees of the Ansett superannuation schemes are sympathetic with the plight of members, such as the caller to John Laws today, who are having difficulty getting their benefits paid. We are keen to see benefits paid out promptly and in full. The problem is that Ansett is in liquidation and all the parties to that liquidation, including the five Ansett superannuation schemes, are in conflict over the remaining Ansett assets. The arbiter of these conflicts is the Victorian Supreme Court. Most of the Ansett superannuation benefits are protected and quarantined by the superannuation legislation and therefore are safe from other creditors' claims on Ansett. However, in some cases, there is a dispute over whether the benefit should be paid at a retrenchment level or a resignation level. Common industry practice in a liquidation scenario is that the payment would be at a resignation level, and schemes would generally be funded accordingly.

The relevant Ansett schemes have not been fully funded for the higher retrenchment level favoured by APRA and the trustee, and would need to be topped up by the liquidator, who takes a different view. I interpose—I did not put this in the statement—that I think you would be aware

that in superannuation the level of an entitlement in a defined benefits scheme has several interpretations to it. There are minimum benefits, vested benefits, accrued benefits, resignation benefits, retirement benefits and retrenchment benefits. In some cases, the minimum—the floor—is prescribed in the legislation but in some cases the trust deed might promise a higher amount. In the cases we are talking about in these Ansett schemes, the trust deed has promised a higher amount than would apply in a resignation benefit.

**CHAIR**—I would like to question you on that. When Ansett initially collapsed, the committee asked APRA a question about the adequacy of the superannuation moneys for the employees. APRA said there were a number of investments and that, subject to market risk—and it was qualified that they were perhaps in high-risk industries such as the airline industry—you believed that adequacy was there. When you made that statement, with the benefit of hindsight now when you are talking about replacement risk, did you respond to us in the knowledge of replacement risk, or is that a new issue since the matter went before the court, as it were?

**Dr Roberts**—In relation to the caller to John Laws and to other people in her circumstances—if we understand her problem—that statement is still correct because there is an issue about top-up entitlements that goes beyond the legal SIS entitlements. We believe the SIS entitlements are, essentially, quarantined and safe.

**CHAIR**—That is the bottom line from our point of view.

**Senator SHERRY**—Nevertheless, it is a retrenchment benefit required by the rules of the fund. APRA's position is that it should be paid, and the trustees also say that. What is the approximate amount of money?

**Dr Roberts**—That is yet to be determined. This is presently before the Victorian Supreme Court.

**Senator SHERRY**—What is the claim? The trustees and APRA are saying, 'This should be paid.' The liquidator is saying, 'No, we're not going to pay the money over to the Ansett funds.' What is the amount of money in dispute? What is the ballpark figure?

**Dr Roberts**—We believe the quantum is probably between \$100 million and \$200 million.

**Senator SHERRY**—What is the approximate number of employees?

**Dr Roberts**—We would have to take that question on notice.

**Senator SHERRY**—Is this holding up the general payout that is not in dispute in the Ansett fund?

**Dr Roberts**—It should only hold up people who have an exposure to this issue.

**Senator SHERRY**—You do not sound very sure. Have the Ansett employees who have been made redundant—this was last year, and we are now well past the middle of this year—received their superannuation payout for the area that is not in dispute?

**Dr Roberts**—I will have to take that on notice to give you a precise answer. I would guess probably not, because this has not been the only legal complexity disputed. There have also been disputes about the deeds and about other aspects of the priority of the superannuation schemes against other creditors. So the Supreme Court has had to deal with more than one issue.

**Senator SHERRY**—This is obviously a very significant issue, given the quantum of money. What is the expected timeframe in which to resolve the dispute, because there are many hundreds of Ansett employees who are very upset?

**Dr Roberts**—This particular issue has been before the court for several weeks. The court will make its own decision, but our best understanding is that there should be a decision within the next month.

**Senator SHERRY**—And if it goes in favour of the view of the trustees and APRA, presumably the liquidator will have to pay over that amount of between \$100 million and \$200 million. Where does the liquidator get the money from?

**Dr Roberts**—The liquidator has access to whatever assets remain. That, of course, is what all the creditors are competing for. So the trustees, with the support of APRA, is seeking to get ahead of the other creditors to get that top-up money.

**Senator SHERRY**—Do they automatically have legal priority if the court says, ‘Yes, the money should be paid by the liquidator to the fund’? Do they have first priority?

**Dr Roberts**—I think, probably, yes.

**Senator SHERRY**—But you are not absolutely sure?

**Mr Venkatramani**—That is also one of the issues. Once these issues are resolved, the question is where would these people stand in the queue, particularly because, as Darryl pointed out earlier, there is this minimum level of benefits. Anything that is promised ahead of or on top of that is more of a contractual right, which, by law, the employer does not have to provide.

**Senator SHERRY**—But that means they have to provide it by law. Surely, if the super trustee requires a payment, that is legally enforceable.

**Mr Venkatramani**—So is the contractual entitlement of a creditor. Where the superannuation fund member stands in the long list of creditors is something which will need to be worked out.

**Mr Brown**—There are two distinct issues here. One is: what is the quantum of the claim against the liquidators? The other is: where is the standing of the super fund in relation to other creditors?

**CHAIR**—It is a question of investment risk—to what extent do other creditors have to suffer if you are going to give priority to matching this gap? Normally the company would put the money in, but the company is gone; it is not in a position to put any in.

**Dr Roberts**—The contractual obligation is between the trustee and the members. I think the trustee wishes to pay the higher amount, so the dispute is then between the trustee and the liquidator.

**Senator SHERRY**—I understand that, but surely from an ex-employee's point of view, when the company has gone and they have lost their job, the first priority should be the employee and their retirement benefit?

**Dr Roberts**—We believe so.

**Senator SHERRY**—I am glad you agree, but we have to wait for the court. Given the call this morning—and there are obviously many hundreds of people affected by this—where should they go? Should they contact APRA? The caller this morning seemed to be unsure about whether she should go to the tax office, APRA or the liquidator.

**Dr Roberts**—We suggest that members communicate with the trustee. The trustees are doing the best job they can. We have confidence in them. They are dealing with a difficult situation in the best way they can. As a result of APRA's efforts and the trustee's efforts, in recent months some moneys have flowed from the liquidators to these schemes that were previously in dispute. The trustees are trying very hard, with our support, to get the maximum benefits flowing. We understand the trustees may be able to pay partial benefits even if the final total is not yet determined because it is still under court consideration. But it is always most desirable that the first port of call for people, in terms of the details of their position, should be the trustee.

**Senator SHERRY**—I understand and appreciate that, and I appreciate and applaud APRA's position in terms of the money, but the difficulty is that it is almost a year since these people lost their jobs. Some of them may not be going back to the work force, for whatever reason, and they may need the money for retirement purposes. How can this be speeded up?

**Dr Roberts**—We have the same view as you, Senator. We would prefer that they had been paid earlier and in full.

**Senator SHERRY**—One other issue, I think compensation has been awarded regarding the Australian Independent Superannuation Fund?

**Mr Brown**—That is correct.

**Senator SHERRY**—It was the theft and fraud.

**Dr Roberts**—That was the Perth one.

**Senator SHERRY**—What was the percentage of compensation awarded in that fund?

**Mr Brown**—It was 90 per cent of the eligible loss.

**Senator SHERRY**—Was that APRA's recommendation to the government?

**Mr Brown**—I do not think it is a matter for us to state that here.

**Senator SHERRY**—But, in law, 100 per cent could be awarded, couldn't it? The law provides for 100 per cent?

**Dr Roberts**—I think the legislation is silent, so it is a matter for—

**Senator SHERRY**—The legislation does allow for up to 100 per cent. It does not specify a figure, but it can be up to 100 per cent, can't it?

**Dr Roberts**—Going back to Wallis—

**Senator SHERRY**—I am not interested in Wallis. I am interested in what the legal position is.

**Dr Roberts**—Our view is that the legislation is silent and the government makes policy decisions.

**Senator SHERRY**—It was not clear. The level of compensation was not in the minister's press statement, as I understand it. It is not in there, is it?

**Mr Brown**—I think it was. I do not have a copy with me, but I believe that it was there.

**Senator SHERRY**—That is why I asked.

**CHAIR**—That is over 100 per cent for some people.

**Mr Brown**—No, because the eligible loss which is defined in the legislation includes both the primary amount which has been stolen or defrauded from the fund and also consequential losses to the fund. That can include the costs of an acting trustee and so on, which would otherwise not have been incurred by the fund. In fact, those components were taken into account in determining what the eligible loss was. It is the case that 90 per cent of that total has been provided to the fund.

**Dr Roberts**—We certainly regard it as a good result.

**CHAIR**—There are still some people in the CNAL group whose entitlements have not been satisfied. Who are these people?

**Dr Roberts**—We would have to take that question on notice.

**CHAIR**—The other point that worries me is that one disaffected person in this group has said to me that they are not getting much communication from the liquidator. In fact, I am surprised that the liquidator did not act on behalf of all those who had lost money to advise these people so that they could make an application to the minister or to you for compensation.

**Dr Roberts**—Do you mean the replacement trustee?

**CHAIR**—He seemed rather reluctant to take that action. I regard that as a dereliction of duty under the circumstances. How do you view it?

**Mr Brown**—It is a matter for the trustee or a replacement trustee to make application for a grant of assistance, not for an individual. There are some self-managed superannuation funds which had an exposure to CNAL products but for which CNAL was not the trustee of their superannuation fund. Of course, self-managed superannuation funds do not fall under the part 23 financial assistance arrangements. Of those for which CNAL was the trustee, all of the APRA regulated funds, the advice that I have is that, for a number of those, the application for financial assistance has been made and has been agreed to. There are other groups of funds where either the application has not yet been made or in respect of which advice has not yet been provided to the minister and there has not been a determination about what, if any, financial assistance should be paid in those cases. This is because there are a large number of funds for which CNAL was trustee and the circumstances of those funds and their exposure to the impaired assets differed according to the different class of fund.

**CHAIR**—Could that be speeded up because obviously it is a bit disconcerting to know that, where two groups under a similar umbrella had different funds, both of which were CNAL funds, one has an entitlement while the other is still waiting for a determination? You have given me the answer, but the matter does need a bit of expeditious resolution.

**Dr Roberts**—We have been in constant contact with the members' action group and the replacement trustee and have always sought to keep things moving fast, but we will pass that on.

**Senator SHERRY**—Regarding the 150 funds that have been given the publicity following the APRA announcement, what are we talking about in terms of members of the funds? One hundred and fifty funds sound like a lot as a proportion of the total number of funds, but what is the approximate number of members of those funds?

**Dr Roberts**—At a guess, we are talking about a few thousand people.

**Senator SHERRY**—A few thousand?

**Mr Venkatramani**—We are talking about small corporate funds, so on average you would take about 50 or 60 members—100 members.

**Senator SHERRY**—I can understand that, given the size of the fund. So as a proportion of the total number of superannuation fund members, which is eight million plus in Australia, it is a very small number.

**Dr Roberts**—Yes, it is.

**Mr Venkatramani**—I also make the point that we are not saying that these funds are in dire difficulty. We have identified some issues, and we are working through them. We do not want a scary headline tomorrow morning!

**Senator SHERRY**—The weaknesses you have identified—investment, in-house related party transactions, defined benefit not being properly funded and breaches of equal representation—are not all issues that relate to loss of money.

**Mr Venkatramani**—They are warning signals.

**Senator SHERRY**—I just want to be clear.

**Senator BUCKLAND**—Let me refer back to your opening statement. At the end of it you said that some 300 or so problematic funds exist in the industry and that licensing might do much to improve the overall safety of the industry. We have had other evidence earlier in these hearings about the problems that could exist with smaller funds, and that is more the case in the environment we are in at the moment. Could you expand on that? I am sorry if I am roundabout with this, but I need to be. There was a suggestion by one group that the larger funds could absorb them—which, I am sure, the larger funds would appreciate—but I do not think that optimism was shared by the smaller funds. The danger I see in that—and I would like your views on this—is that some of these smaller funds might seek to amalgamate, which in itself might create some real dangers for the investors' money. What are your views on such a move?

**Mr Venkatramani**—When we say that some 300 small or problematic funds could accept, subject to whatever licensing regime comes into place, we are talking about applying a test at the entry level. If they want to run their super fund properly with proper risk management systems and controls, they need to pass a minimum bar. As you know, we have recently been through a reasonably sized licensing exercise for general insurers. Our sense is that a lot of people may genuinely prefer to upgrade their systems and controls, but some cannot. Some factors are related to the size, because the minimum effective system and control requires a particular sized investment and it cannot be efficient or cost-effective for a very small fund to attempt that.

Our super system currently allows for a fund to transfer members either with consent, or without consent under a successor fund mechanism, provided the rights are equal in the new fund. We are not suggesting that in respect of all of them there is a genuine immediate problem about members' balances being paid. As Roger pointed out earlier, our job is to look forward to see whether there are enough signals to give us cause for concern and whether we can do something in time to make sure that those existing signals do not result in actual concerns. What we are saying is that we would set it up at such a level that we could be confident as regulators and prospective licence issuers that, under normal circumstances, these funds would make it and members' balances would be safe. If we are not able to do that and a licensing regime were to

come into place, we do need to say to some of them, ‘Sorry. You cannot not be in the system, so you need to do a few things. Some of them could merge, and some of them, as I indicated in my opening speech, could go down the smaller road. Not everyone would go to the bigger, greedier sector. Some of them might go under the ATO rule and, if they are small funds, they could become self-managed super funds.

**Dr Roberts**—The most common practice that we have found with funds that are exiting, with encouragement or not, is that for the ones who have the self-managed culture, we will encourage them to be structured and to go to the tax office. The ones that stay in the APRA system quite commonly go to an approved trustee where there is already licensing and a higher degree of supervision. So it is not actually very common for two small funds to merge into a slightly bigger fund.

**Mr Brown**—I think your question was: if you do have funds merging or winding up, does that create a situation of increased risk? Our experience is yes. Whenever you have significant change in an institution that means that your risks are higher. Particularly for funds that are weak in terms of their management and governance, those risks are going to be escalated. It follows from that that, whether a fund is winding up or we are advised that it is intending to merge, we will have a much closer relationship with that fund over that transitional period than we would have in the course of normal supervision for a small, low impact fund. By the same token, that does not guarantee that it will go without drama.

**Senator BUCKLAND**—Of course not.

**Mr Venkatramani**—As Roger pointed out, when a fund is in the process of winding up, that is one occasion when the risks would be very much magnified—things like fraud, lack of records, member balances and assets being properly transferred. Very recently, we issued guidance to the industry and professions on the kinds of steps to take and the control mechanisms we would expect to be in place if they are in the process of winding up. And, provided we know that it is occurring, our own supervisors would be out on alert to monitor that those things are happening.

**Senator BUCKLAND**—So if the regulator and the supervisor were out there and they saw two small funds looking to merge, what role does the regulator have in that? Can the regulator come in and say, ‘That is not going to happen,’ or ‘These are the strict guidelines that you are going to have to work under to bring yourselves together’? I know quite a few people who are in smaller funds and I am concerned about their futures.

**Mr Brown**—Under current law we do not have the power to direct a trustee as to what they can and cannot do. We can, of course, replace a trustee if we consider that their actions are such as to put the fund into a position of financial risk. But in the ordinary course of events, no—our approach would be one of consultation with the trustee, providing advice and possibly going as far as recommendation, but we could not actually direct or force a course of action in the circumstances that you are describing.

**Senator BUCKLAND**—What is APRA’s attitude in relation to licensing the individual as opposed to the fund as a whole?

**Mr Venkatramani**—We need to license the trustee. How would we license individuals? Our system relies on the trustees being responsible for managing. We would be looking at the board of trustees and their risk management systems and controls to be able to say, ‘Yes, we are reasonably satisfied that this will work.’

**Mr Brunner**—We already have a licensing framework for approved trustees—some 150, or so—and it would be a similar concept that we propose to extend to all superannuation funds.

**Senator BUCKLAND**—My question was a little bit too hasty there. The question I wanted to pick up on comes from your submissions. Is it more appropriate to license the funds or the fund manager—the custodian—and the administration service providers?

**Mr Venkatramani**—At this point in time we are taking a cue from other industries which we regulate. Our licence goes to the board. We have other control mechanisms, like the kinds of relationships which they have with other outsourced service providers such as administrators, investment managers et cetera. Very recently you might have heard that we issued a binding standard on authorised deposit takers in relation to outsourcing. We have come out publicly and said that that is the model we would like to see adopted, with appropriate changes for other industries which we regulate. We say, ‘If you are trying to outsource particular important activities’—in saying this, I am mindful of the fact that super is perhaps the most outsourced of all the industries that we regulate—‘these are the kinds of controls you need to have, this is what your contract will typically contain and these are the mechanisms you need to put in place.’ In particular, you need to define what will happen when the relationship gets into difficulties because that is one of the biggest difficulties in terms of access to records, assets et cetera for super. We would try and control it that way, rather than licensing every party along the way.

**Senator BUCKLAND**—I will just ask one last question and I will conclude my remarks on that. I would like you to reflect on the pros and cons of requiring super funds to have annual general meetings of the fund members in a similar way, I suppose, to the way shareholders’ meetings are conducted.

**Mr Venkatramani**—We think that in concept it is a wonderful idea, because it espouses democracy and member participation et cetera. But if you look at the expediency, especially since SIS came into being, one of the problems that all of us in the industry have is to actually get members to take a reasonable interest in what is going on. Perhaps I am exaggerating it a bit here, but if you could get members to actually look at their annual statements and try and understand what is in them—that their contributions have gone in and that their insurance cover is what the contract said it should be—I think we would be doing very well.

We also need to understand what this is likely to achieve. In relation to public offer funds there is already a requirement for policy committees, where members’ views can be felt. We have had no evidence that the existing complaints mechanism does not work. There is equal representation in relation to corporate funds. Every year some of the larger funds would have to send out thousands of requests. What this is likely to achieve that cannot be achieved in a better way—particularly given the fact that I mentioned earlier, that the trustees cannot be directed by members—is something that is not very clear to us. Therefore, we believe that, on balance, the

current system can be improved without necessarily going through an AGM route. We think that the costs will outweigh the benefits.

**Senator BUCKLAND**—Let's forget democracy—what is a fair way for people to have access to the managers of their funds? I may not share the same views as you as to how many people read their annual statements. I would suggest to you that the vast majority of people these days in fact do read their annual statement related to their superannuation fund. Experience suggests that to me. It is not my own experience; I have never read one in my life—I have a wife to do it for me—but I do know what is happening with my superannuation. That is why I ask you to reflect on that. There are shareholders' meetings of companies that are much smaller than superannuation funds, where there is much less financial support to do all of those things you need to do to call a meeting together. I suppose you have answered the question, but it really has not answered the question—I can see the cons from your answer, but I did not see too many pros in that.

**Dr Roberts**—I think we agree that there should be a good communication channel between a member and the trustee, but that should be throughout the year. The member should be able to get on the phone and get information from the trustee any day of the week.

**Senator BUCKLAND**—They can do that. What they cannot do is get access to the trustee—they get an agent of the trustee, which is a very different thing. I think this is an opportunity—similar to facing up to the board of management—for you to go there and confront the actual people who are controlling the funds.

**Dr Roberts**—If they are fobbed off on the phone, we would suggest that they write to the trustee. One way or another, they should be able to get the trustee to respond to their question or their comment. Having thousands upon thousands of annual meetings would be impractical and not cost-effective.

**Mr Brown**—In terms of their access, the situation is a little different, depending on whether you are talking about a public offer fund or a standard employer sponsored fund. In the latter case, where you have equal representation on a trustee board and a requirement that the trust deed provide a mechanism for periodic election or selection of trustee representatives, that provides the route, and the members should, in both theory and practice, be able to access the member representative trustees if not the board as a whole. In respect of public offer superannuation funds, if an employer sponsor has selected that fund for them, there is a requirement for policy committees to represent groups of 50 or more employees. If that person has chosen to be in that fund they have the ultimate way of communicating with the fund, if they are not happy with what is going on, by taking their money out and placing it somewhere else.

**Senator BUCKLAND**—At the end of the day, it comes back to the question that has been posed to you earlier today about educating people in relation to superannuation. We do not seem to have any answers from anyone on the best way to do that.

**CHAIR**—What action has APRA taken to respond to the relevant recommendations contained in their first report on prudential supervision?

**Dr Roberts**—We will have to take that on notice in order to remind ourselves of the recommendations.

**CHAIR**—Are any APRA staff now placed with industry, on exchange, to gain experience? I know you recruited some people from industry.

**Dr Roberts**—Not to my knowledge.

**CHAIR**—How many technical staff have you recruited in the last 12 months?

**Mr Venkatramani**—When you say ‘technical’, almost all the front-line supervisors we recruit have technical background. They are either accountants, actuaries, legal professionals, or business trainees.

**CHAIR**—Have they had prior experience of at least three years in the industry? Do you wish to take that on notice?

**Dr Roberts**—I am not sure we would have that information. I think it gets down to when we are recruiting we give them what we can afford to pay and so on. We try and get the best people that we can. We recruit some graduates and they have to learn on the job at the time, plus we give them internal training. We also try and recruit laterally from the industry, and we get some people that way. There is a wide mix of backgrounds. Normally, people would have some business degree of one kind or another and quite often some industry experience either in insurance, banking or superannuation. It would be quite hard for us to categorise it for you.

**CHAIR**—In paragraph 5 of your opening statement you state:

And we are achieving some good outcomes with the enhancements to our enforcement powers that were recently enacted by Parliament.

However, in paragraph 3 you state:

These two sets of tools are used in combination: regulation without adequate supervision is a forlorn hope; supervision without adequate regulation is a toothless tiger.

Are you appealing to our committee to give you additional powers?

**Dr Roberts**—We would like a standards making power and a licensing power; that is what we are appealing for.

**CHAIR**—Can you articulate on that a little more?

**Dr Roberts**—That would enable us to make a standard similar to what we have in our banking and insurance regimes. That would be a disallowable instrument that would require a period of industry consultation and be subject to parliamentary disallowance, but one which we would be able to get in place more quickly and amend more easily than a regulation that has to go through the Office of Legislative Drafting and so on. The most notable example—the first

cab off the rank if we got this power—would be an investment standard to discourage some of the problems that we have listed here.

**Senator SHERRY**—The in-house and related party stuff.

**Dr Roberts**—Yes. Greg can probably answer this.

**Mr Brunner**—Our support for standards making power was, I think, first outlined in our submission to the Productivity Commission last year. We also made it clear during the Superannuation Working Group consultation process that APRA was a strong supporter of having a standards making power similar to the power that we now have for all of our other industries—deposit taking, life insurance and, more recently, general insurance. The life insurance one was brought in also in about 1999. We have standards making powers for all of our industries, except superannuation.

**CHAIR**—Coming back to page 2 of your submission: you have uncovered some very serious issues there—about seven, eight or nine issues. What sort of action do you take in relation to defined benefit funds in deficit?

**Dr Roberts**—This is quite a topical issue because of the negative returns over the last year. It also goes to what we were talking about in relation to Ansett—the difference between the minimum benefit and the accrued benefit. Because of the way the defined benefit funds work, there is a triennial actuarial certification. The actuary will make assumptions of adequacy based on what scenarios they think are realistic, but they will not require the fund to reach a level that is 100 per cent certain of meeting the accrued benefit in every conceivable circumstance because that would be incredibly expensive. As a result of that you do get from time to time an actuarial shortfall in a defined benefit fund. Usually the employer will restore that over a reasonable period of time, but our reason for listing it here is that we are concerned of a need to keep the pressure on employers to restore those shortfalls as quickly as possible.

**CHAIR**—This leads me to the question: how is it that auditors can sign off on these sorts of funds where they have these sorts of deficiencies?

**Mr Venkatramani**—If we are specifically talking about defined—

**CHAIR**—It is shoddy record keeping.

**Mr Venkatramani**—Okay. If you are talking more broadly—

**CHAIR**—No, I am going through your minor points. How is that auditors can sign off the accounts as being correct in accordance with standards and in accordance with the law when there are these sorts of problems—excessive in-house assets, defined benefit funds in breaches of equal representation, lack of control over service providers? Should we have a very prescriptive audit report so that the audit report has to tick off on these sorts of issues? They are under scrutiny at the moment, and you pick these up, obviously. The trustees are responsible; they have been remiss; now we come down to the auditors. Why aren't they picking them up? Why aren't they reporting on them? Do you remember that we came up with a recommendation, a

couple of reports back, that the auditor for the fund should be independent of the auditor of the company, so that they can raise these sorts of issues without fear or favour?

**Mr Venkatramani**—Some of these, like in-house assets and defined benefit funds in deficit, are objective tests. Our experience is that most auditors would pick those up and comment on them or raise them with the trustees. But some of the others are, if you like, prudential concerns in a forward-looking fashion.

**CHAIR**—It is one thing that they have raised them with the trustees, but they have to report to somebody. They should have to report these sorts of things to APRA.

**Mr Brown**—Your suggestion that the audit reports be quite prescriptive—

**CHAIR**—We have talked about where there is a systemic breakdown they have to report to you but, looking at this list, it seems that it should be a lot wider.

**Mr Brown**—There are a substantial number of compliance measures that auditors are required to report on in the annual report to the trustee, which is copied to APRA. There is also the requirement in section 129 of the SI(S) Act that if as part of their audit work the auditor observes contraventions of SIS, they are required to report that in writing to the trustee. If they are dissatisfied with the rectification measure the trustee puts forward, they are obliged to report that to APRA.

**CHAIR**—But there are 150 who have not, obviously. Perhaps you have picked it up now.

**Mr Brown**—I would not link the 150 with these particular issues. We find that the performance of auditors varies in the same way that the performance of funds and trustees varies. Unfortunately, you can find the correlation between a second- or third-rate trustee and the sorts of service providers, including auditors, they select.

**CHAIR**—Why don't you wipe them out if you are unhappy with the standard of their performance?

**Mr Venkatramani**—We do.

**Dr Roberts**—We have disqualified auditors.

**CHAIR**—How many in the last 12 months?

**Mr Brown**—I do not believe we have disqualified any in the last 12 months; I will leave it at that.

**CHAIR**—These are all serious issues, aren't they?

**Dr Roberts**—Yes, they are.

**CHAIR**—How do we best address them? I am seeking your advice; here is your big opportunity.

**Dr Roberts**—Our view is that it is a combination of issues. None of the tools that we have in our regulated industries—licensing, capital, where we have such standards, and auditors and actuaries—has proved to be a panacea in its own right. It is a combination of tools—the auditors picking up some things, our on-site visits picking up some things, licensing tests, having an investment standard—that eventually minimises the scope for a trustee to be careless or dishonest. If the trustees in every fund were fit and proper in the first place, I do not think the auditors or APRA would have to do anything at all.

**CHAIR**—That is the very problem. That is when we need the auditors to be very vigilant. One possibility is having the government auditor responsible and able to contract out that supervision, or even APRA could contract out. At least you would then have some control over reporting on these sorts of weaknesses.

**Mr Venkatramani**—In fairness to the auditing profession, several times we have come across these issues because auditors have told us that they have a problem with a fund. So we should not take the view that auditors are the same; there are good auditors. When these kinds of issues come up we also talk to auditors, and we have had the practice of looking at auditors' working papers to see how they draw their conclusions and what kinds of testing they do. Where that is insufficient or inadequate, we have had meetings with auditors to tell them. At the first instance we tell them, 'Go and get some training. We need you to be properly trained to do this fairly complex piece of work.' Where that does not work, we have said in the past—although not in the last 12 months, as Roger pointed out—'You cannot be a superannuation auditor.'

**CHAIR**—This softly, softly approach is all right, but you want some definite action within six months that they have come up to scratch otherwise they have to be wiped out. I am sorry to say that.

**Mr Brown**—I also indicate that where we have a significant difficulty with a fund, with the sorts of characteristics that are outlined in this submission, our first priority is to restore the health of the fund. At the time that the issue comes to notice, we will say, 'Who is involved in this fund? What other funds are they involved with? Can we be reasonably confident that there will not be a contagion effect—that this person will not represent a danger in other circumstances?' If our answer is that the auditor has a measure of responsibility for having failed to identify the issues, but the auditor is not involved with other APRA regulated funds, we can say, 'Let's leave that one for the time being while we focus on the restoration of the fund, making sure that the money which is in the fund is secure—if money has gone out of it inappropriately, that that is restored to the fund.' We address the issues with the trustee first and then the auditor takes his place in the queue to be addressed. It can be addressed by way of training and it quite frequently is addressed by way of the auditor undertaking to us—though not necessarily by way of a formal enforceable undertaking—not to audit other APRA regulated funds in the future. It can be addressed by way of disqualification. At the present time, there are auditors to whom we have issued letters, asking them to show cause as to why they should not be disqualified. We have some processes in train at the present time.

**CHAIR**—I put a suggestion to you: why shouldn't you be writing to all your APRA auditors, drawing attention to these typical weaknesses and ensuring that they attend to these matters by qualifying the report or reporting to you? We have to be serious about this issue.

**Dr Roberts**—We will take that on board, Senator. A couple more comments could be made. I think Ramani mentioned that we do have an ongoing liaison with the auditing profession, including groups that are set up for each industry.

**Mr Brown**—In the various states as well.

**Dr Roberts**—There is an ongoing liaison between the auditing professions for each industry.

**CHAIR**—Still, there are a lot of people involved.

**Dr Roberts**—One of the issues here is not that the faults have not been identified; it is getting them rectified once they are identified. In that regard, the standards making power would help us, because one of the things that goes with the standards making power is a directions making power. At present, as Roger was saying, our approach is to identify the weaknesses and negotiate with the trustee to rectify it. Quite often, they do that. If we want to go up a level and put more pressure on the speed of rectification, we now have the enforcement undertaking tool. If they will not agree to an enforceable undertaking, which gives them a deadline and milestones, the standards making power will enable us to issue them with a direction to rectify an issue. If they do not comply with the direction, we would be able to go to the court and have the judge enforce it. That is why that standards making power and the ability to make directions—

**CHAIR**—If you just took them to court over some of these issues—that wakes people up pretty smartly, doesn't it?

**Dr Roberts**—Where they are corporate governance weaknesses, they are not strictly illegal.

**Mr Venkatramani**—They are control weaknesses.

**Dr Roberts**—There are warning signs that we think exhibit some governance weaknesses, but you will not find a sentence in SI(S) that says that it is a breach for you to do this.

**Senator SHERRY**—I have just a couple of quick things. Flowing on from this prudential standards issue that you have referred to on two previous occasions, wouldn't that, in some areas at least, stifle innovation in new investment classes—securitisation, infrastructure, ethical investments, developing capital products?

**Dr Roberts**—It might stifle them if they are on the speculative or exotic end of—

**Senator SHERRY**—How do you make that judgment?

**Dr Roberts**—I think it is a matter of referring to conventional investment theory. Entities need to have an investment strategy that is prudent, conventional and which provides for

liquidity and so on. Derivatives can have good benefits, but they also provide the scope for leverage and speculation, which is why we are much more cautious in allowing funds to enter into derivatives contracts willy-nilly, whether it is securitisation or some other kind of thing. There is a certain element of investment activity that is appropriate outside the superannuation system but which you want to restrict within it.

**Mr Venkatramani**—In fact, I would go to the other extreme and suggest that a prudential standards making power, given that we are able to react quickly to market developments, will actually encourage innovation because the market will be able to move with the certainty that the regulator has assessed the risk and believed that, within constraints and set parameters, particular products are acceptable. So we would actually argue—

**Senator SHERRY**—What if somebody offers a new product on the market? I assume it was your predecessor, ASC—what did it do with, say, derivatives, when they emerged on the market?

**Dr Roberts**—We brought in the risk management statement, which required funds engaging in derivatives activity to have a very precise set of objectives and controls. But this is not a new power in terms of financial regulation. As Greg said, this is a power that we use in banking and insurance and no-one has ever complained to us in the banking industry, which is always coming up with new and complicated financial instruments, that it restricts their commercial freedom.

**Senator SHERRY**—Regarding your letter of response of 1 August and the query we had on salary continuance insurance and the sole purpose test, did we provide a copy of the particular product, the statement that I had?

**Mr Venkatramani**—I am not sure that we had the statement.

**Senator SHERRY**—The secretary might be able to help here. Did we provide APRA with a photocopy of that insurance product that had the salary continuance in it?

**CHAIR**—With the 90 per cent? No. I think we should put it to APRA.

**Senator SHERRY**—Where do you draw the line? Is a 10 or 15 per cent premium cost against superannuation contributions unreasonable? Or is 50 per cent? You say 90 per cent; I would certainly accept it, but how you draw the line?

**Dr Roberts**—It is a judgment. If we did not draw lines at all, the sole purpose test would creep out—

**Senator SHERRY**—I am not suggesting that we do not draw lines. Have you ever had any cases referred to you with respect to what could be argued to be an excessive insurance cost? Have you had to make a decision about whether it contravenes the sole purpose test?

**Dr Roberts**—I am not aware of that.

**Senator SHERRY**—Apparently you were not given the document, so I will make sure that it is sent to you through the committee secretariat.

**Mr Brunner**—We did receive some documents about public hearing evidence given in Melbourne.

**Senator SHERRY**—Yes, that is the transcript but it was not the actual document.

**Mr Brunner**—No, it was not the actual document but it gave us the flavour of the product.

**Senator SHERRY**—Do you consider something that takes 10 to 20 per cent off the retirement income to be unreasonable?

**Mr Venkatramani**—To answer your question in a fairly indirect way, our system says that certain basic benefits must be provided if you need to qualify as a complying super fund and access tax concessions. On top of that, it says that certain ancillary products can be offered. That is largely left to the marketplace as to what people want to do with it. Our sense is that, given the fact that we have not had too many complaints, the kind of freedom which has been provided to the marketplace has been used responsibly.

Occasionally, however perfect a system may be, product design could mean that there are people at the fringes who are adversely affected because, if you have a fairly small balance and there is a compulsory element of salary continuance insurance, you could be adversely affected. It is a benefit design issue. That is where you would expect the trustees and employers—most of them are employers funds—would probably sit down and talk about whether there is any need for the benefits to be refined. Should there be a default option? Should there be a greater element of members choosing the basic cover being set at a fairly low level?

**Senator SHERRY**—But isn't there an argument that, whether it is compulsory or voluntary, the argument should focus on whether or not it is so pricey that it is excessively drawing down on what is supposed to be retirement income benefit?

**CHAIR**—We have your paper on that. Thank you very much for it; it was quite handy.

**Dr Roberts**—I do not think there are any simple answers.

**Mr Venkatramani**—When you talk about what additional add-on features should be found in a super scheme, you are talking about a policy issue.

**Senator SHERRY**—Let me put it this way: is the objective of superannuation to provide a top-up unemployment benefit?

**Dr Roberts**—No, I do not believe so.

**Senator SHERRY**—Salary contingency in some circumstances is a top-up of unemployment benefit, isn't it?

**Mr Venkatramani**—It could be, yes.

**Dr Roberts**—That is the difficulty with all these things. As Ramani said, what can be a relevant benefit for a certain beneficiary can be an unwarranted cost for another one. Is financial planning a valid ancillary benefit? It might be for some members and not for others.

**Senator SHERRY**—Have you declared that contrary in the sole purpose test?

**Mr Venkatramani**—We have. We have actually clarified under what circumstances we would accept trustees spending members' money in a super fund on financial planning. We have very clearly said that it must relate to the choices available within the super fund, and should not be more generic, because we were concerned about exactly the point you are making.

**Senator SHERRY**—Do you weigh up whether or not a financial planner should sell, say, access to a master trust product? Do you do that as well? Do you say, 'We consider these fees and charges to be excessive because they are debited against the contributions?' Do you make judgments about that?

**Mr Venkatramani**—As long as it is within the suite of products offered within the superannuation fund, we have said the trustee could organise some advice to be given to members so that they can choose responsibly, but we have very clearly said, to the extent that it relates to the more generic managed investment products such as negative gearing and all those things which you do outside of the super structure, that superannuation funds should not be spending members' money on those.

**Senator SHERRY**—What about a commission agent who sells a product such as access to a master trust? Do you ever have to make a call about the level of fees or commission that they debit against the contributions?

**Dr Roberts**—Most funds would make those decisions themselves, because—

**Senator SHERRY**—I understand that, but have you ever had a complaint about that?

**Dr Roberts**—Not to my knowledge.

**Senator SHERRY**—You do not get involved in that?

**Mr Brown**—We have, in a few instances, encountered people selling a multi-employer fund to small and medium employers rather than to individuals and where the level of administration fee being charged to the fund—which was then indirectly subsidising the agents—was excessive, in our view. The instances of those which come to mind predate our access to the enforceable undertaking power, and our response to them was moral suasion as heavy as we could exercise, in essence, given the limitations on our powers at the time; we nagged the trustees to death. In at least one instance I felt it was a signal of success that the fund wound up. They decided it was too hard and they went away. For that reason, amongst many, I welcomed the enforceable undertaking power. It would have made life very much simpler at that stage.

**Dr Roberts**—I think that is the more appropriate way to handle it. If something glaring comes to our attention we try and deal with it in that way. Whenever you try and have prescriptive rules to cover the whole industry, because of the diversity of funds and people's circumstances they become a very blunt and difficult instrument.

**Senator SHERRY**—We asked ISFA to give us these documents—these key feature statements that are now being printed. Does APRA examine these as well?

**Mr Venkatramani**—That is an ASIC issue, basically.

**CHAIR**—Mr Venkatramani, thank you very much for your response to our letter in relation to superannuation and standards of living in retirement. We would be very happy if you would put that on the APRA web site. I think it would provide useful guidance and be a mechanism to advise trustees because it is a fairly comprehensive paper.

**Mr Venkatramani**—Yes, we will do that.

**CHAIR**—It is a public submission, so there will be no problem.

**Mr Brunner**—We will certainly look at the mechanics of that.

**CHAIR**—That could be useful in terms of guiding trustees. That is a good response, so thank you. In your submission, you talk about the fragmentation of the industry. Can you help us in relation to the word 'fragmentation'?

**Dr Roberts**—We regard ourselves as a mainstream financial regulator. In a mainstream financial, banking and insurance regulator, which has licensing and a manageable population, the tools work with a better balance than we have now. For example, we have 40 to 50 banks, and in the order of 200 credit unions and building societies.

**CHAIR**—I just have to warn you that we have lost our quorum.

**Dr Roberts**—We will imagine that Senator Sherry is here in spirit!

**CHAIR**—It is just in case you mention a name or something.

**Dr Roberts**—There are 200 insurance companies. The traditional tools work best with that kind of manageable population, and also where you have peer groups within a population. For example, when we collect financial statistics—which we normally do quarterly for our other industries—we take those financial statistics and compare them with the benchmarks for a peer group. That is one of the tools we have. They would show all the credit unions of a certain type and size, and their normal performance over the quarter, and whether there is any particular credit union out of line. If there is, we then drill down to try and identify the reason for that. That is not possible with superannuation because we have thousands of funds. They vary from the ones with under \$1 million in assets to the 370-odd that have over \$60 million in assets. So it is a very heterogeneous industry; there are a lot of funds and a lot of variation in the type of funds. As you know, we only get annual data from them. We do not get quarterly data from

them because of the size of that population and the cost that would impose. We do not visit them as often, even though we are trying to visit them at least every two years. It is not as often as we visit banks and insurance companies. We cannot use the peer group analysis to the same extent to do our internal risk assessments.

The number of super funds, the diversity in their size and the way they operate their trust deeds—they are not regulated by SIS and there are commercial differences in their individual trust deeds—means that the traditional tools have to be leveraged; we have to work them that much harder to get the same kinds of results that we get in banking and insurance.

**CHAIR**—Some people have suggested that, by having to comply with both the management investment act as well as SIS, the compliance costs are quite high. What is your view?

**Dr Roberts**—We have always taken the view with all our regulation that what we ask for is commercial good practice. Therefore, a well-run fund should be able to satisfy all the regulators and its own trustee board. If it is not satisfying one or more of those parties, then it probably has weaknesses in its governance. If it is well run, all the regulatory requirements will be consistent.

**Mr Brunner**—Sometimes when comments like that are made, they are made on the assumption that there is duplication. I would argue that that is largely not the case and certainly ASIC and APRA try, wherever possible, to ensure that that does not happen. We also need to be mindful of the fact that ASIC and APRA regulation are for different purposes. ASIC regulation is for market conduct purposes and disclosure purposes, whereas APRA regulation is for prudential purposes. The sort of information that we seek from funds differs because of those different purposes. There is certainly cooperation in relation to the audit compliance certificate, for example, which is completed. There are aspects in that compliance certificate which APRA will be collecting, on behalf of ASIC, even to the degree of collecting information that is now required following the financial services reform legislation and the Corporations Law rather than SIS. We are trying to be a single collection point for that compliance information, whether it be Corporations Law information or SIS information. When we receive information on those compliance certificates which suggests there are problems we pass it on to ASIC. We are trying to cooperate there as well to reduce compliance costs.

**CHAIR**—Thank you very much for your individual contributions. I think it has been a very fruitful meeting today.

**Committee adjourned at 5.41 p.m.**