Chapter 3

Transparency in reporting requirements

3.1 This chapter examines issues raised during the inquiry that relate to the regulatory arrangements pertaining to the reporting requirements of superannuation funds. The first explores the debate over whether promotional advertising complies with the sole purpose test, including discussion on how such expenditure should be disclosed to fund members. The second is the use of the term 'not for profit' by industry funds in the context of third party transactions with service providers, and the propriety and transparency of these relationships. Finally, the chapter examines complaints from the superannuation industry about the inefficiencies and cost associated with regulatory overlap.

Promotional advertising

3.2 Promotional advertising is an established practice for industry and retail superannuation funds in Australia. It has become increasingly important to their survival in a competitive marketplace. It is estimated that in the twelve months to November 2006, industry funds spent $18.8 million on advertising, accounting for 83.5 per cent of the $26.1 million spent on superannuation advertising in that year, up from 72 per cent in 2005.[1]

3.3 During the inquiry, the committee examined the operation of the sole purpose test in the context of advertising undertaken by trustees on behalf of fund members. The hearings saw extensive discussion on the appropriateness of this practice, particularly in the light of the 'compare the pair' and 'A lifetime of difference' super choice advertising campaign by Industry Funds Services (IFS) that sought to highlight the advantages to investors of industry funds over comparable retail funds. In May 2005 IFS suspended its advertising campaign following concerns that consumers might have been confused by the advertisements. In June of that year, the Australian Securities and Investments Commission (ASIC) accepted an enforceable undertaking from IFS in relation to the advertising campaign.

3.4 According to ASIC Deputy Chairman, Mr Jeremy Cooper, the advertising campaign by IFS reinforced ASIC's view that all advertising about choice of superannuation fund must be clear, accurate and unambiguous, with the correct level of detail set out for consumers:

---

1 Brendan Swift, 'Choice of fund inspires super spending', *Australian Financial Review*, 10 January 2007, p. 42, based on research by Nielsen Media Research AdEx. Industry funds point out that they represent only 7 per cent of advertising within the financial services sector, compared with a 38 per cent share held by financial planners and a 22 per cent share by market and retail super funds. See, for example, Industry Super Network, *Submission 77*, p. 13.

> ASIC will continue to work cooperatively with the superannuation industry to ensure that any concerns are resolved quickly and in the interests of better information to consumers. We certainly don't want to stop funds from explaining the benefits of their products to consumers, provided they don't go too far.[2]

Sole Purpose Test

3.5 The sole purpose test and associated standards contained in section 62 of the SIS Act prohibit the use of concessionally taxed superannuation savings for purposes such as providing pre-retirement benefits to members, benefits to employer sponsors or facilitating estate planning. The test ensures that the retirement income objective remains paramount. Specifically, the test requires that each superannuation fund be maintained solely for core purposes as set out in the legislation.[3]

3.6 The three legislated core purposes are:

- provision of benefits for each fund member on or after the member's retirement from any business, trade, profession, calling, vocation, occupation or employment in which the member was engaged;
- provision of benefits for each fund member on or after the member attaining the age of 65; and
- provision of benefits to a legal personal representative or dependants of a fund member on or after their death, provided that the death occurs prior to age 65.

3.7 The test also requires that funds be maintained for one or more ancillary purposes, which include:

- provision of benefits for each member on or after termination of employment with an employer who had contributed for the member;
- provision of benefits where the member temporarily or permanently falls ill and ceases work;
- provision of benefits to a member's legal representative or dependants where the member dies after reaching age 65; and
- provision of other benefits approved by the Australian Prudential Regulation Authority (APRA). Circumstances commonly covered by this purpose include hardship or long service leave.[4]

3.8 The test encompasses the normal activities of fund trustees, including the levying of reasonable charges against contributions of fund assets to pay for services

---

2 ASIC, 'Industry Fund Services agrees to change advertising', Press Release 05-148, 3 June 2005.

3 Comprehensive coverage of the Sole Purpose test can be found in *Superannuation Circular no.III.A4*, Australian Prudential Regulation Authority, February 2001.

4 SIS Act section 62(1)(b), regulations 6.01, and schedule one items 103, 108, and 109.

being provided to members, provided those services are reasonably incidental to the running of the fund. The test allows legitimate administrative expenses, including fund sponsored member awareness, education and financial advice programs so long as they are directed at specific superannuation-related issues. APRA's advice states that, as a general guiding principle, there should always be a reasonable, direct and transparent connection between particular trustee action and the sole or ancillary purposes.[5]

3.9 In its submission, APRA reproduced a letter sent to all funds under its regulation offering guidance in relation to promotional advertising. The letter addresses factors going to the appropriateness of directing members' funds to various advertising and promotional activities, and delineates between member education, marketing to retain or expand membership, joint campaigns, external financing, and selection of service providers. Consistent with its previously published Circular, APRA wrote that member education in relation to features of the fund was usually permissible, but that broad financial literacy campaigns should not be undertaken using members' assets.

3.10 In relation to retaining existing members or seeking to recruit new ones, the letter said, in part:

> In our view, imposing marketing expenses on current members primarily to attract new members is difficult to justify [and] imposing marketing expenses on current members where the benefit of such expenses falls primarily to the trustee (by way of enhanced remuneration) or other parties would be inconsistent with the sole purpose test and may give rise to inequities among generations of members.[6]

Industry views

3.11 The majority of witnesses appearing before the committee viewed advertising as a fact of the modern, market-oriented superannuation industry and defensible as an appropriate activity connected to the core purposes prescribed in the SIS Act and regulations. Besides arguing that advertising is a basic necessity, a number of witnesses argued that greater market share brought with it efficiencies that were directly beneficial to investors. Some of the areas in which economies were said to be achieved were office accommodation, governance, auditing, accounting, legal, quality review and systems technology costs.[7]

3.12 Superpartners took a popular line, arguing that the greater membership flowing into industry funds as a result of advertising brought about efficiencies of

---

5 *Superannuation Circular no.III.A.4*, Australian Prudential Regulation Authority, February 2001, para. 42.

6 Letter to trustees of all APRA-regulated superannuation funds, Mr Ross Jones, 14 March 2005, reproduced from APRA, *Submission 51*, p. 11.

7 Industry Super Network, *Submission 77*, p. 14.

scale that served the investor well. The greater the membership the more costs could be spread and driven down.[8] This view was echoed by REST Superannuation:

> In regard to the payment of advertising from the fund, we genuinely believe that this can be justified as a legitimate expense in the correct circumstances. Section 62 of SIS, that is, the sole purpose test, sets out that each trustee of a regulated super fund must ensure that the fund is maintained solely for the provision of retirement benefits for each member of the fund. Whether spending the fund's money on promotional advertising is in conflict with this test, that is a test that needs to be addressed by each trustee. We hold the view that existing members of a fund benefit from promotional advertising as it helps to assist existing members to stay with the fund and educate them about the benefits of the fund or enables new members to join the fund, potentially giving greater economies of scale.[9]

3.13 Industry Super Network (ISN) argued that industry funds saw advertising as entirely consistent with the sole purpose test:

> We have said all along that we are certainly not looking for any exemption from the sole purpose test. We think it ought to be judged in terms of the sole purpose test. We think the economies of scale in the superannuation industry generally are so overwhelming that almost the reverse case can be made; that unless trustees are doing really active things about trying to grow their membership base—and their funds under management, in particular—then maybe they are not really carrying out the sole purpose test, which is to maximise the benefits for the fund members. That is simply because, other things being equal, the unit cost per member can be expected to be lower as a fund grows or if a fund is bigger than other funds.[10]

3.14 Through its involvement in the 'compare the pair' advertising campaign and its sponsorship of a football team, HostPlus argued that it took a targeted approach to promotional advertising:

> These promotional activities are undertaken to sustain and enhance our membership base through building the brand and brand awareness. That largely enables us to build on the economies of scale which in turn provide us access to competitive management and administration fees, which, as I think you will all agree, is ultimately in our member's interests. Our strategy is tailored to reach our membership, who are predominantly in the

---

8 Mr Frank Gullone, Chief Executive Officer, Superpartners, *Committee Hansard*, 25 October, Melbourne, 2006, p. 15.

9 Mr Damian Hill, Chief Executive Officer, REST Superannuation, *Committee Hansard*, 24 October, Sydney, 2006, p. 57. See also, for example, Mr Michael Potter, Director, Economics and Taxation, Australian Chamber of Commerce and Industry, *Committee Hansard*, 6 March 2007, Melbourne, p. 43; ESI Super, *Submission* 85, p. 014; Members Equity Bank, *Submission* 64, p. 4.

10 Mr Garry Weaven, Spokesperson, ISN, *Committee Hansard*, 6 March 2007, Melbourne, p. 28. See also, for example, Equipsuper, *Submission* 30, p. 14.

> 21- to 40-year age category. They are typically disengaged with their superannuation, and it is difficult to reach them solely through some of the traditional channels, such as the annual members statement and annual reports. So building our brand through TV advertising and through our association within the sporting industry is critical to our activity in the same way as administration and investment management. Advertising is a legitimate cost, just like any other costs that the fund incurs, whether they be administration or investment costs. It should not be considered any differently. As we have heard previously from others who have discussed this issue, its primary objective is to retain our existing members, build on the existing membership base and grow our funds under management, which all lead to greater economies.[11]

3.15 HostPlus used practical examples to demonstrate how efficiencies are achieved through growth in membership:

> Certainly a good case in point as it relates to HostPlus is that we were able to increase the level of insurance benefits that our members received by a minimum of seven per cent last year at no additional cost to the members. We were able to negotiate with our insurer increased benefits, and it did not cost our members any additional moneys whatsoever. I think this really highlights the true nature of what you can do if you have economies built into your membership base.[12]

3.16 The submission from ISN was also illustrative of the economies of scale achievable through maximising the quantum of funds under management:

> The relationship between scale of funds under management and investment charges is also probably fairly well known. As an indication, for a standard active Australian shares mandate, costs can range from below 0.3 per cent of assets under management to almost 2 per cent, with the largest factor being the size of the mandate.[13]

3.17 Fund research organisation SuperRatings argued strongly for the right to advertise, to the extent of claiming that a board of directors which fails to address the need for promotion is potentially compromising the success of their business and the financial wellbeing of their clients.[14] The Self-Managed Super Fund Professionals' Association of Australia (SPAA) also saw advertising as an integral part of running a superannuation fund:

> Advertising is interesting, because whether it is done internally by the superannuation fund or externally by a service provider to those particular

---

11 Mr David Elia, Chief Executive Officer, HostPlus, *Committee Hansard*, 6 March 2007, Melbourne, p. 55.

12 Mr David Elia, Chief Executive Officer, HostPlus, *Committee Hansard*, 6 March 2007, Melbourne, p. 55.

13 ISN, *Submission 77*, p. 14.

14 SuperRatings, *Submission* 49, p. 9.

> funds, it would seem that promotion is part and parcel of superannuation. To get people educated and to have them understand particular products within the industry is probably worthwhile.[15]

3.18 This approach was also taken by Mercer Human Resource Consulting, which viewed the issue in the following terms:

> In our view, funds have to obtain new members to remain viable. How do you obtain new members? You can do it in a number of ways. You can advertise, you can pay salesmen commissions to attract new members, or you can pay employees to go out on a salary basis and recruit new members. If you are going to ban one, should you ban all three? We find it very difficult to see how you can effectively stop one segment of the industry from attracting members in a particular way …we need to recognise that the super industry has been through a significant structural change, and yet that is still happening. The number of funds in the industry is still diminishing. We are suggesting that within five to 10 years, the top 10 funds will represent perhaps 40 per cent of the industry, if you exclude the public sector and the self-managed super funds. They will be major financial services players, whether they are an industry fund, a bank or some other player. All of those players will have a brand. That brand is important, and it will be advertised in a variety of ways, whether it be through a sales force, direct advertising, or on the internet, et cetera. Member information is important. We live in a competitive environment. Those funds will compete with one another in all sorts of ways. I think that is a fact of life that is part of fund choice. We need to recognise that.[16]

3.19 Rainmaker Information spoke strongly about the nexus between a market-based, free choice super regime and the ability to advertise. It called for the focus to be shifted to a lowering of overall operating costs:

> The whole point of super choice is to open the market to competition and to let consumers choose who should look after their money. Therefore, it is a force for good, in our view, because it simply democratises the industry. It puts the focus on members and not just employer sponsors or their union sponsors. In this environment advertising can be necessary because it is simply a very cost-effective way to communicate with large numbers of members and large numbers of prospective members. We believe imposing advertising restrictions just because it is superannuation is anti choice, anti consumer, anticompetitive and even, dare I say, unAustralian. Our plea is simply that people concerned about advertising costs should really be fighting to minimise total operating costs and passing these savings on to members as the lowest possible fees. Again, we are concerned that we could be trying to solve the wrong problem. Even worse, advertising controls could be tantamount to trying to tell trustees how to actually run

15 Mr Graeme Colley, Director, SPAA, *Committee Hansard*, 24 October 2006, Sydney, p. 6.

16 Mr John Ward and Mr David Knox, Mercer Human Resource Consulting, *Committee Hansard*, 25 October 2006, Melbourne, p. 73. See also, for example, Mr Jeff Bresnahan, Managing Director, SuperRatings, *Committee Hansard*, 7 March 2007, Sydney, pp. 4-5.

> their operating budgets, which we think—while it might be ideal in some cases—could actually end up being quite naive and unworkable. [17]

3.20 A small number of respondents argued against allowing industry funds to advertise using members' money. Typical of these was Fiducian Portfolio Services, who considered that advertising during prime time on television was needlessly expensive, and was of dubious utility.

> Industry funds are known to be charging their funds for advertising. Much of this is done during prime time viewing and is costing their members millions of dollars that could well be credited to member accounts. As well, we are of the opinion that the salaries and expenses of not for profit funds and industry funds are being paid be members. We cannot understand what benefit industry groups and unions can gain by participating in the financial services industry.
>
> …
>
> It would be interesting to know how many millions of dollars have been spent by industry funds on advertising and how this money would have benefited their members instead of the television campaigns[18]

3.21 The Financial Planning Association of Australia (FPA) questioned whether general advertising met the sole purpose test:

> In the view of the FPA, any general advertising by a fund does not arguably meet the "sole purpose" test under SIS as it is not directly related to any of the core purposes of a fund. Additionally, the general trust law does not on the face of it seemingly authorise a trustee to reimburse itself for the cost of general advertising as it would not seem to fall within normal administration activities of the trustee.[19]

3.22 The FPA also raised concerns relating to ancillary benefits, such as entertainment, which may fall to trustees or managers as a result of advertising activities. At the very least, it argued that such spending and ancillary benefits should be disclosed to members.[20]

Conveying information

3.23 A number of witnesses saw inherent value in the role of advertising in the provision of information to members or potential members. The Association of Superannuation Funds of Australia (ASFA) saw advertising not simply as a means of attracting business, but as a method of continuing financial education:

---

17 Mr Alex Dunnin, Editorial and Research, Rainmaker Information, *Committee Hansard*, 24 October 2006, Sydney, p. 74. See also Mr David Elia, Chief Executive Officer, HostPlus, *Committee Hansard*, 6 March 2007, Melbourne, pp. 55-56.

18 Fiducian Portfolio Services*, Submission* 18, pp. 4-5.

19 FPA, *Submission* 38, p. 13.

20 FPA, *Submission* 38, p. 13.

> Partly it is knowing what their fund does. It is almost education. If I look at some of the promotion that is going around, my view is that it is as much aimed at those who are currently members of the fund, so that they understand what they are members of and why, as to get new members. One of the things that we do know is that a lot of people unfortunately do not know much about their fund. In a sense the visibility of the fund acts as much as an education event as it does to get other new members in.[21]

3.24 Superpartners saw a link between choice and deregulation in the industry with the recent increase in advertising, pointing out that advertising was directed:

> … [N]ot only [at] promotion of those funds but education of members in terms of understanding what the industry funds stand for. It has come about, really, as a result of choice and it has proved to be beneficial, based on anecdotal evidence. Members have a better understanding of what industry funds are about.[22]

3.25 Superpartners reminded the committee that provision of information and efforts by funds to increase membership were not solely self-serving for super funds:

> A key component of a fund's management is a retention strategy as part of its business plan. When APRA conduct an on-site review of a fund, the first thing they say is, 'Show us your trust deed and your business plan.' So APRA is quite interested in seeing that a fund, as a matter of prudential management, conducts a strategy to retain and grow its membership.[23]

Disclosure of advertising costs

3.26 Other witnesses, while not arguing against advertising by funds per se, were unconvinced of the utility of it, and saw wisdom in requiring full disclosure to investors. The FPA was typical in expressing this sentiment:

> We do not necessarily have a problem with advertising per se. We are simply saying that we do not necessarily think it is actually part of a super fund's obligations, but if you want to advertise and if you have a cost allocated to it and if you are able to pay for it then at least members ought to know what that cost is and they need to accept that that is a cost. You can argue the toss as to whether it is education, promotion or otherwise as long as members first and foremost are aware of that cost and accept it. I would question whether a lot of the advertising is about education, because it is a very competitive market out there.[24]

---

21 Dr Michaela Anderson, Director, Policy and Research, ASFA, *Committee Hansard*, Sydney, 24 October 2006, p. 33.

22 Mr Frank Gullone, Chief Executive Officer, Superpartners, *Committee Hansard*, 25 October 2006, Melbourne, p. 13.

23 Mr Paul Collins, Manager, Legal Services, Superpartners, *Committee Hansard*, 25 October 2006, Melbourne, p. 16.

24 Ms Jo-Anne Bloch, Chief Executive Officer, FPA, *Committee Hansard*, 24 October 2006, Sydney, p. 40.

3.27 The Investment and Financial Services Association (IFSA) was similarly circumspect, hinging its support for advertising on full accountability. It concluded that advertising should be clearly permitted but that:

> …[advertising costs are] coming from the funds, and in good faith they are expending that money to get a bigger slice of the market, a bigger membership base, and they say they are getting economies of scale. If that does not happen, someone has to be brought to account.[25]

3.28 The tendency of some funds to incorporate advertising costs into other administrative expenses has led some in the industry to advocate separate disclosure. Professional Associations Superannuation Limited (PASL) was a case in point:

> I think the annual report should separately itemise a variety of different sorts of information, one of which would be advertising. I think it should be separately recorded, as should be details of any major contracts that are applicable. I think open disclosure of all information is the approach that we would prefer.[26]

3.29 Some witnesses considered audited financial statements to be a better alternative to the annual report as a means of disclosure, although variation in the content and specificity of financial statements was identified as a possible barrier to achieving complete transparency.[27] The Association of Financial Advisors suggested that the cost of all advertising and promotion should be stated in whole dollars at the start of the annual report.[28]

Committee view

3.30 The committee notes the widespread support for the trustees' ability to advertise using member funds and the main arguments used by respondents in support of their case. The committee notes broad consensus on the positive role of advertising to educate members about fund features. Increased advertising is an inevitable consequence of superannuation funds competing for business, which was the main objective of the Choice of Fund legislation. It is in relation to advertising and promotion for the purposes of retaining or attracting members that difficulties arise.

---

25 Mr Richard Gilbert, Chief Executive Officer, IFSA, *Committee Hansard*, Sydney, 24 October 2006, p. 105. See also Mr Terry Brigden, Member, Superannuation Committee, Law Council of Australia, *Committee Hansard*, 7 March 2007, Sydney, p. 64; Institute of Chartered Accountants in Australia, *Submission 43*, p. 7; CPA Australia, *Submission 65*, p. 8.

26 Mr Kevin Beasley, Chief Executive Officer, Professional Associations Superannuation, *Committee Hansard*, Melbourne, 6 March 2007, p. 10. See also Ms Susan Ryan, President, Board of Directors, Australian Institute of Superannuation Trustees, *Committee Hansard*, 25 October 2006, Melbourne, pp. 85-86; Dr Peter Burn, Associate Director, Public Policy, Australian Industry Group, *Committee Hansard*, 7 March 2007, Sydney, p. 70.

27 See, for example, Mr Jeff Bresnahan, Managing Director, SuperRatings, *Committee Hansard*, 7 March 2007, Sydney, p. 5.

28 Association of Financial Advisors, *Submission 62*, p. 10.

APRA's view contrasts with the view of the majority of submitters, many of whom are actively engaged in advertising and promotion with the stated purpose of achieving economies of scale through the attraction of new members.

3.31 The committee can see merit in both approaches to the issue, and suggests that the regulator and industry might find common ground in compulsory and specific disclosure by funds of expenditure on advertising and promotion. One approach explored briefly by the committee focused on the possible relevance to the superannuation industry of Australian accounting standards. To this end the committee wrote to the Australian Accounting Standards Board (AASB) seeking information on whether it was developing an accounting standard for the not-for-profit sector. The committee asked how a proposed standard would apply specifically to promotional advertising, sponsorship and executive remuneration. The committee also wrote to ASFA asking whether any peak superannuation industry bodies had been involved with the AASB in developing a not-for-profit sector standard.

3.32 The AASB responded by informing the committee that its Accounting Standards are 'transaction neutral', requiring the same treatment for like transactions by all for-profit and not-for-profit entities, including public sector entities. It noted that the treatment of promotional advertising, sponsorship and executive remuneration in the not-for-profit sector would be accounted for and disclosed in accordance with the requirements in AASB 101, *Presentation of Financial Statements*, and AASB 124, *Related Party Disclosures*. The AASB noted further that it is currently reviewing AAS 25, *Financial Reporting by Superannuation Plans*, issued in March 1993 as a 'one-stop-shop' for financial reporting by superannuation plans. The AASB has agreed that that any replacement standard for AAS 25 should apply to all superannuation plans, irrespective of whether the plan, its trustee or its responsible entity is regarded as for-profit or not-for-profit.[29]

3.33 The AASB has not considered the accounting treatment and disclosure of promotional advertising, sponsorship expenses and executive remuneration by superannuation plans, but expects to sometime in the future:

> To date, the AASB's deliberations in relation to superannuation plans have focused on the measurement and disclosure of assets held by superannuation plans and pooled superannuation plans. Considering the increased emphasis now being placed on the disclosure of fees and charges by superannuation plans, the disclosure of promotional advertising and sponsorship expenses and executive remuneration is a topic that the ASB will need to address in its future deliberations.[30]

29 AASB, correspondence, 18 April 2007.

30 AASB, correspondence, 18 April 2007.

3.34 ASFA also responded to the committee's request for information on this issue, noting that it has been actively involved in the current review of AAS 25 through its nominee on the AAS 25 Expert Advisory Panel.[31]

Recommendation 4

3.35 The committee recommends that peak superannuation bodies and APRA continue to work with the Australian Accounting Standards Board with a view to forming appropriate compulsory accounting and disclosure by all funds for promotional advertising, sponsorship expenses and executive remuneration.

'Not for profit' funds and service providers

3.36 The committee examined whether industry funds using the phrase 'not for profit' is legitimate in the context of their contractual arrangements with service providers. Other phrases commonly used are 'all profits go to members', 'run only to profit members' and 'profit for members'. Administrators, fund managers, and insurers are examples of service providers remunerated by superannuation funds.[32]

3.37 The Institute of Chartered Accountants in Australia described 'not for profit' and related terms as 'misnomers':

> These terms are misnomers as all superannuation funds pay for administration, investment and other services. The difference between funds is whether the entity being paid for providing these services is related or unrelated.
>
> A superannuation fund which is a product offered by a listed entity frequently engages related companies as its service providers. The profits of the listed entity would include those of all of its trustees together with its related service providers. By contrast, where an industry or corporate fund engages service providers, these are more likely to be unrelated. However these arms-length service providers fees would also include a percentage of profit for the owners of the service provider. Thus the fees of all superannuation fund trustees would include elements of 'profit', regardless of whether they are classified as retail, corporate or industry funds.[33]

3.38 Mr Steve Blizard from Roxburgh Securities argued that industry funds:

> ...choose to utilise the concept of "no one makes any profit – but the members".
>
> This may be true, after all the other participants contracting to the Industry Super Funds have taken their profits. Some serious questions need to be asked about who is making money out of the Industry Super Funds?

---

31 ASFA, correspondence, 30 April 2007.

32 FPA, *Committee Hansard*, 24 October 2006, Sydney, p. 41.

33 Institute of Chartered Accountants in Australia, *Submission 43*, p. 7.

> The Industry super funds generally contract out the services of numerous Investment Managers, Auditors, Lawyers, Asset Consultants and Administration Service Companies.[34]

3.39 However, ASIC said that the use of the term is legitimate in the context of a superannuation trustee without responsibilities to shareholders:

> When used in a corporate context, 'not for profit' does not mean that it does not make a profit. It means that profits are not distributable to shareholders, either by way of dividend or in the event of a winding-up. That is the well-established meaning of the term. I think we are talking about net profits in all of those circumstances, which are the profits after all of the costs of administration. In a sense, it is not inherently misleading for a superannuation trustee entity that does not have external shareholders to whom dividends are payable to describe itself as not for profit in a way that would not be open to an ordinary, say, publicly owned company.
>
> I see nothing inherently misleading about that, nor is that general perception undermined by the fact that, along with the rest of the superannuation industry, payments are made to third-party service providers.[35]

3.40 The submission from ISN offered a more forthright assessment:

> It is ludicrous to suggest that industry super funds are not entitled to use such terms because businesses providing funds with services generate a profit from that business.[36]

3.41 The more salient issue relates to the propriety and transparency of these arrangements; in particular related party arrangements where a competitive tendering process for service provision has not been undertaken. Section 52(2)(c) of the SIS Act requires superannuation trustees to act in the best interests of their members. Consequently, the relevant question to be considered is as follows: is the related party agreement an arms length commercial arrangement or is the superannuation trustee being overcharged for the provision of services?

3.42 IFSA commented that the potential for excessive payments to service providers was equally applicable to all superannuation funds:

> Fees paid in a superannuation context eventually end up in the hands of individuals, whether shareholders, employees, or service providers further down the chain. The fundamental issue and responsibility of trustees is not whether the remuneration paid is "for profit" or "non-profit", but rather whether it is "reasonable" or "excessive" reward for the activities performed for the fund. The principle that the trustee act in the best interests

---

34 Mr Steve Blizard, *Submission 3*, p. 10.

35 Mr Malcolm Rodgers, Acting Commissioner and Executive Director, Regulation, ASIC, *Committee Hansard*, 20 November 2006, Canberra, pp. 64-65.

36 ISN, *Submission 77*, p. 15.

> of members is enshrined in law. "Not for profit" entities can pay excessive rewards for services just as much as "for profit" entities.[37]

3.43 The committee heard that transparency and disclosure were key factors in determining whether or not trustees were acting in their members' best interests on this issue. The Law Council of Australia told the committee that 'not-for-profit' funds needed to exercise care when disclosing third party transactions:

> Certainly it is true that, if you do have a related service provider providing administration or other services, I think that has to be disclosed. It is part of a cost of a fund. Also, if a trustee is doing it internally it would be purely on at least a cost recovery basis if you assume it is not for profit. If a third party is doing it, whether they are related or not, that immediately raises the question of whether they are doing it on just a cost recovery basis or for cost recovery plus profit. If a related party is doing it on profit then I think you do have to be careful about how you explain that. I think if you then said, 'Yes, we are not for profit,' without a qualification, that could arguably be misleading.[38]

3.44 FPA was one organisation that suggested a lack of transparency existed over arrangements between trustees and service providers:

> The relationship between many Industry Funds and their service providers is an issue of concern for financial planners advising clients due to the lack of information available and the apparent lack of "arms length" contractual arrangements and detailed disclosure of these arrangements.[39]

3.45 In evidence, IFSA told the committee that the importance of superannuation warranted a consistent approach to disclosure:

> We are talking largely about public money, public savings, and the requirements that apply to public companies in relation to disclosure, and those requirements should apply in a superannuation context regardless of whether the entity that is the trustee is a public company or not.[40]

3.46 However, Mercer Human Resource Consulting warned the committee that more onerous disclosure requirements might impose unnecessary costs:

> I would not have a problem if trustees were required to disclose some of their related parties, where that impacts on the particular fund. I am just concerned that, if we go too far down the track in treating trustees as public companies, there are a lot of unnecessary additional costs that would not

---

37 IFSA, *Submission 60*, p. 32.

38 Law Council of Australia, *Committee Hansard*, 7 March 2007, Sydney, p. 61.

39 FPA, *Submission 38*, p. 15.

40 Mr David O'Reilly, Policy Director, IFSA, *Committee Hansard*, 24 October 2006, Sydney, p. 103.

> necessarily relate to an improvement in disclosure that is relevant to members.[41]

3.47 Australian Industry Group also questioned the relative merit of more rigorous disclosure in this realm:

> ...where does it end, how much information are you providing, what is the integrity of the information and what is the utility of the information? People can sit around and think of lots and lots of things where there are small risks and they can impose significant costs on people to address those small risks and feel good about it.[42]

3.48 Reflecting concerns over funds advertising their 'not for profit status', FPA stressed that full disclosure was important to clarify these relationships:

> ...a number of services delivered to those not-for-profit funds are necessarily delivered by service providers who do make a profit. We think that there is some confusion out there between what really is not for profit within a super fund and some of the service providers providing services to those particular super funds. We do not argue with the status. We simply say that the related parties should be disclosed and that the relationship should be understood, because we think that there is some confusion.[43]

3.49 However other organisations told the committee that the framework for properly monitoring these arrangements is already in place. APRA told the committee that the licensing process compelled the disclosure of related party transactions:

> ...for any of those sorts of arrangements, the trustees are expected to be able to show that they had formal arrangements in place, that there were termination dates, how they chose particular service providers and so on. So the process [is] no different between a retail, an industry or a corporate in that sense.[44]

3.50 The Australian Institute of Superannuation Trustees stated that accounting standards dictated they must be disclosed already:

> ...there is full disclosure on related party transactions in the audited accounts of every fund, to which every member has access. That is a requirement of the law from an accounting standard point of view.

---

41 Mr John Ward, Principal and Manager, Mercer Human Resource Consulting, *Committee Hansard*, 25 October 2006, Melbourne, p. 66.

42 Dr Peter Burn, Associate Director, Public Policy, Australian Industry Group, *Committee Hansard*, 7 March 2007, Sydney, p. 67.

43 Ms Jo-Anne Bloch, Chief Executive Officer, FPA, *Committee Hansard*, 24 October 2006, Sydney, p. 41.

44 Mr Ross Jones, Deputy Chairman, APRA, *Committee Hansard*, 7 March 2007, Sydney, p. 99.

> Members can get access to that if they so choose. It is no different from a public company.[45]

3.51 This was confirmed by CPA Australia, with the caveat that more prominent disclosure is not always beneficial to members:

> It is in the financial statements. The super funds et cetera pick up all of the normal accounting standards that would apply to any other entity plus whatever is in AAS25. So the related party disclosures, the remuneration issues and all those sorts of things are sitting in the financial statements for the super funds, which do not necessarily get sent in full to the members but the members are told in the annual report that they can request the full set. So the information primarily is there. In theory, disclosure is good, but a lot of disclosure can create unnecessary noise, and it is a question of whether the noise is going to add any value or whether the disclosure is going to add any value or is it just going to add noise?[46]

3.52 ISN maintained that industry funds disclose all service fees and related party transactions:

> As industry super funds grew, they identified many areas where the services they were obtaining from third party providers were overpriced or underperforming. As a result, industry super funds have used their collective scale to renegotiate the terms on which business is conducted in the industry or to create businesses which aim to provide superior service delivery to the funds or their members or provide services at a lower cost. Some of these collective vehicles also provide investment opportunities for the funds.
>
> Where these collective vehicles are owned by the industry super funds, profits which are generated are returned to the superannuation funds, either through dividend payment or capital appreciation and are disclosed in the funds' annual reports along with all the other fund investments.[47]

3.53 Another suggestion to ensure members do not pay excessive rates for fund services is to mandate a competitive tendering process for service provision agreements. SuperRatings expressed the view that competitive tendering ought to be mandatory, otherwise the market rate for such services cannot be satisfactorily determined on behalf of members:

> ...every trustee company should tender every service to the market on a regular basis to ensure that the members are receiving the best benefits. A trustee director's responsibility or fiduciary responsibility is to act in members' best interests at all times. What has happened historically, until

---

45 Mr David Coogan, Treasurer, Board of Directors, Australian Institute of Superannuation Trustees, *Committee Hansard*, 25 October 2006, Melbourne, p. 82.

46 Ms Noelle Kelleher, Member, Financial Advisory Services Centre of Excellence, CPA Australia, *Committee Hansard*, 25 October 2006, Melbourne, p. 61.

47 ISN, *Submission 77*, p. 15.

> we have shaken some funds up more recently, is that they have had the one administrator, they have had the in-house investment team, and they have had the in-house insurance arrangement. Our comment to them has been, 'How do you know that that insurance arrangement cannot be improved upon significantly externally?
>
> ...
>
> There is no way that a board can satisfy themselves that it is competitive without knowing what the other parts of the market are doing. In a lot of cases, they have been reluctant to do that. It is across the board. The report that we are currently running on eligible rollover funds, which account for something like $5.5 billion, has found that there is huge evidence of related party transactions in that specific area, and that is disappointing.[48]

3.54 It indicated that the problem was particularly acute with eligible rollover funds, given they are primarily comprised of lost members who will not scrutinise fee levels.[49]

3.55 APRA told the committee that competitive tenders are not compulsory, but are 'strongly suggested':

> We have not said, 'If you do not do it, you are in trouble.' All that we have said is that it would be good practice. But the more fundamental tests are: how are you able to determine, given your fiduciary obligations, that whatever you are proposing is in the best interests of the members; having chosen a service provider, what kind of arrangements are you putting into place; what kind of pricing have you obtained and should things go wrong—and we are talking about operational risks here—which will happen from time to time, what are your remediation control measures? We even ask, 'What would be your termination arrangements and, should termination occur, how would you make sure that ongoing service to the members takes place?' Those tests are common across the industry.[50]

3.56 APRA emphasised the importance of funds meeting the objective of getting the best deal for their members.[51]

3.57 The Australian Institute of Superannuation Trustees indicated that tendering was not critical as long as APRA's requirements are met:

> ...there is an outsourcing standard as one of the requirements of APRA's licensing, and in those outsourcing standards, it does not matter what type

---

48 Mr Jeff Bresnahan, Managing Director, SuperRatings, *Committee Hansard*, 7 March 2007, Sydney, p. 9.

49 Mr Jeff Bresnahan, Managing Director, SuperRatings, *Committee Hansard*, 7 March 2007, Sydney, p. 9.

50 Mr Senthamangalam Ventkatramani, General Manager (Central), Specialised Institutions Division, APRA, *Committee Hansard*, 7 March 2007, Sydney, pp. 99-100.

51 APRA, *Committee Hansard*, 7 March 2007, Sydney, pp. 100-101.

> of fund you are, you need to set out the procedures for reviewing and monitoring all services providers. It really applies to both areas of the market, and it is up to the trustees to work their way through that as they see fit.
>
> Some trustees will put out to tender; they will have a tendering policy across their different service providers and set out a program for all service providers over a period of time. Others, given the nature of the service and because they have done benchmarking to satisfy themselves that they are getting the right service at the right sort of market rates, that they are not out of the market, they may choose not to go to tender as such.[52]

Committee view

3.58 The committee agrees with ASIC's statement that the use of the 'not for profit' label is not misleading as a consequence of payments to third party service providers being made. Paying for services essential to the running of a superannuation fund is a normal cost of administration incurred before net profit, which if directed back into the fund justifies the term's use.

3.59 From the committee's perspective the issue of whether members are getting a reasonable deal on these transactions is more significant. It is imperative that related party transactions for the provision of services are conducted at arms length and that overpricing is not occurring. This applies to funds of all types, not only the 'not for profit' industry funds.

3.60 During the inquiry the committee received no evidence of impropriety in relation to related party service agreements. However, it notes that the issue was raised with Industry Super Network (ISN) at a hearing in Melbourne on 6 March 2007, in the context of administration services provided to a large number of industry funds by Industry Fund Services Pty Ltd. The main issue discussed was whether there is adequate transparency and disclosure of these third-party relationships.[53] It followed concerns previously raised by former Chief Executive Officer of the Association of Independently Owned Financial Planners, Mr Peter Johnston, and others about whether members of industry funds were informed about the income derived by Industry Fund Services Staff Equity Trust (IFS-SET) from its extensive involvement in the administration of their superannuation savings, and how that income was disbursed. These concerns were also raised by Senator Chapman in the Senate on 24 June 2004.[54]

---

52 Mr David Coogan, Treasurer, Board of Directors, Australian Institute of Superannuation Trustees, *Committee Hansard*, 25 October 2006, Melbourne, p. 83.

53 *Committee Hansard*, 6 March 2007, Melbourne, pp. 21-25.

54 Senator Chapman, 'Industry Funds Services Pty Ltd', *Senate Hansard*, 24 June 2004, pp. 25293-96.

3.61 At the hearing, ISN spokesperson, Mr Garry Weaven, tabled a document responding to claims of a lack of transparency in the relationships between industry funds and Industry Fund Services. It concluded by noting: 'The industry superannuation fund network has consistently argued for maximum disclosure of fees and charges of superannuation funds and for the outlawing of sales commissions in the selling of compulsory superannuation as a precondition for a successful choice of fund regime'.[55]

3.62 To assist the committee, ISN agreed to take on notice questions arising from the hearing. However, the committee is concerned that ISN subsequently declined to provide any responses that might have provided a better understanding of the mutual structure and operation of superannuation funds within ISN. ISN representatives were the only witnesses to the inquiry who explicitly refused to supply the committee with further information when requested. The decision by ISN not to provide answers to the Chair's questions was unhelpful and therefore fails to allay concerns about the cost of third party transactions with service providers. The committee is concerned that fund members are not fully informed when it comes to investing their superannuation savings if industry funds are not disclosing the true cost involved in their administration. Senator Chapman's Adjournment speech of 24 June 2004, ISN's tabled response and the committee's questions on notice to ISN are included in Appendix 4.

3.63 Notwithstanding these concerns, it is not apparent to the committee that the current framework fails to ensure that trustees overall are not acting in their members' best interests when making these arrangements. Accordingly, the committee makes no recommendation for legislative change in this area. It does reiterate, though, that trustees of superannuation funds should continue to exercise caution in this area and continue to tender out service provision agreements wherever possible.

Recommendation 5

3.64 The committee recommends that the government formulate and implement an effective disclosure policy for both product disclosure statements and annual reports to address any deficiencies in reporting related party transactions.

Recommendation 6

3.65 The committee recommends that trustees of superannuation funds publicly tender key service provision agreements.

Regulatory overlap

3.66 The committee was informed of overlapping regulatory responsibilities, which have resulted in a duplication of compliance tasks and increased business costs.

---

55 Response to Speech of Senator Grant Chapman incorporated in Hansard – 1.56am, 24 June 2004. made on behalf of Garry Weaven, Executive Chair, Industry Fund Sendees Pty Ltd (IPS) and Mr Sandy Grant, Managing Director of IPS.

Organisations complaining of the problem cited the potential for an improved delineation of regulatory responsibilities, as well as deficiencies in communication and information-sharing between regulators, as the main contributing factors.

3.67 IFSA outlined the duplication of administrative effort caused by regulatory overlap, questioning whether it is matched by any regulatory benefit:

> With five regulators (APRA, ASIC, ASX, RBA and ACCC) responsible for various aspects of regulation of the investment and financial services industry the efficiency of both regulation and the industry is dependent on a clear delineation of responsibilities. When each regulator develops and pursues their individual objectives without cognisance of the others requirements overlaps, duplication and conflicts are inevitable.
>
> Each regulator may claim that their individual requirements are justified given their unique objectives but the industry is entitled to question whether any additional public benefit that might be derived from a duplicated requirement is not outweighed by the complexity and inefficiency it introduces when the core objectives are already achieved by another regulator's more general requirements.[56]

3.68 CPA Australia commented on the communication deficiencies between regulatory agencies that request similar information:

> The main issue is the level of duplication and the apparent lack of coordination or consistent interpretation between the regulators. Both APRA and the ATO regulate superannuation funds under the SIS Act. Yet their interpretations can vary widely, for example, the definition of fund rules. Similarly, trustees had to provide similar information to ASIC and APRA to apply for their AFS and RSE licenses, yet there was very little information shared between the regulators.[57]

3.69 Superpartners contended that the practical distinction between the roles of ASIC and APRA had become 'blurred':

> Consumer protection overlaps with prudential management and risk control. This is because consumer protection not only involves protection at point of sale (making an informed decision to invest) but also extends to ensuring the safety of the consumer's investment. The safety of an investment in turns depends on the integrity of the risk controls (APRA) and the effectiveness of corporate governance (ASIC).
>
> ...
>
> In recent times, the distinction between ASIC and APRA functions has become more obscured with the ASIC licensing regime extending to superannuation funds, rather than exempting funds to remain under full APRA supervision. While risk management of a superannuation fund is

56 IFSA, *Submission 60*, pp. 11-12.

57 CPA Australia, *Submission 65*, p. 4.

> regulated by APRA, risk management of a managed fund is regulated by ASIC. Corporate governance of a non-superannuation corporation is governed by ASIC while a superannuation fund must comply with APRA-regulated rules of fitness and propriety for directors and Board equal representation as well as complying with the ASIC corporate regulation (in the case of corporate trustees).[58]

3.70 AXA commented on the practical inefficiencies caused by ASIC and APRA's dual regulatory responsibility over superannuation funds:

> On several occasions over the last twelve months, AXA has provided large volumes of material relating to our superannuation funds and the trustees to one regulator, and then provided the same material to the other regulator at a later date.[59]

Breach reporting

3.71 More specifically, a common complaint was the differing breach reporting requirements under both the AFS and RSE licensing regimes overseen by ASIC and APRA respectively.[60] ASFA told the committee that the absence of a materiality threshold for APRA-related breaches is problematic:

> ...on the APRA side is that in particular there is no materiality threshold as there is on the Corporations Act side. ...The lack of a threshold means that the regulator runs the risk of being swamped with a large number of non-material, non-significant breaches being reported. Questions that get discussed range from the ridiculous to the sublime, such as, 'Do I have to report a spelling mistake in a product disclosure statement?' I know that people kind of laugh it off, but people are actually discussing those kinds of things in this area.[61]

3.72 AXA also complained of being required to report breaches of the Corporations Act to both regulators, citing it as an example of a lack of co-operation between them:

> A trustee's obligation to report breaches of the law to APRA under the RSE licence include breaches of a range of Corporations Act provisions, breaches of the SIS Act and breaches of the Financial Sector (Collection of Data) Act. Such breaches must also be reported to ASIC. Aside from the cost of reporting an issue, in different forms, to each of the two regulators, compliance costs are compounded by the different approaches taken by

58 Superpartners, *Submission 67*, pp. 26-27.

59 AXA Asia Pacific Holdings, *Submission 45*, p. 12.

60 See for example ASFA, *Submission 68*, p. 33.

61 Dr Bradley Pragnell, Principal Policy Adviser, ASFA, *Committee Hansard*, 24 October 2006, Sydney, p. 22.

> each of the regulators to the ongoing reporting and rectification requirements relevant to the reported matter.[62]

3.73 Industry Funds Forum told the committee of the costs of duplication in this area:

> The duplication of trustee obligations to report breaches to ASIC and APRA adds significantly to compliance costs. In addition the absence of any materiality limitation on breaches to be reported to APRA is onerous and costly. [63]

A single regulator for superannuation?

3.74 A number of submitters argued that a single regulator overseeing a single licensing regime should have responsibility for superannuation.[64] RCSA and PASL stated:

> It is our opinion that there should be one regulator for all funds including SMFs, with the ATO maintaining a role confined only to the taxation aspects of the superannuation system. This would result in a far less complicated and less costly compliance environment.
>
> It would also be less confusing for the membership in circumstances where there is a complaint in respect of a fund. At present there is a lot of confusion as to which regulator a disgruntled member can approach for a solution.[65]

3.75 Superpartners also recommended that the two regulators be merged:

> With their repeated overlap in functions, there should be no cultural reasons against merging the two regulators. The two regulators have a fundamental common purpose of protection of the public and promoting confidence in the Australian financial system. The case for merging ASIC and APRA into a single entity is compelling.
>
> While we recognise there have been efforts to reduce the regulatory overlap and clarify the demarcation between the two regulators, the fundamental issue of two regulators or one must be directly confronted. Any inquiry into the structure and operation of the superannuation industry cannot avoid consideration of this issue which goes to the heart of the effectiveness of superannuation regulation and the costs of compliance for participants in the industry.[66]

---

62 AXA Asia Pacific Holdings, *Submission 45*, p. 13.

63 Industry Funds Forum, *Submission 73*, p. 37.

64 See for example Industry Funds Forum, *Submission 73*, p. 37.

65 RCSA and PASL, *Submission 56*, p. 12.

66 Superpartners, *Submission 67*, p. 28.

3.76 Alternatively, despite its concern over regulatory overlap, IFSA expressed its support for the 'twin peaks' approach to regulating the industry:

> Our support is still for the twin peaks. The industry invested very heavily in the twin peaks, and in terms of our industry they have actually worked quite well. We have had some problems, but there has not been amongst our members any major failings, and investors in our industry have not lost money as a consequence of poor regulation. Yes, we did have HIH, but that has gone on and we have now changed certain arrangements to better protect the general insurance industry. Our position remains that we have two regulators.[67]

3.77 It added that an amalgamation of ASIC and APRA could produce detrimental regulatory outcomes:

> The...point about moving to a single regulator from two is the risks you have during the transition. Regulators have a whole culture of having an eye on the ball, people not worried about their jobs tomorrow or whether they are moving from Canberra to Sydney, and some say that the HIH failure was a failing of the fact that we moved the ISC into APRA. So we have to be very careful in making massive movements in terms of regulator change.[68]

Other suggested remedies

3.78 Those who identified problems with regulatory inefficiencies, but did not advocate amalgamating regulatory agencies, offered a number of other suggestions to improve the present situation. These generally focused on legislating to clarify responsibilities and adopting better administrative practices to ensure agencies share information that is supplied on multiple occasions.

3.79 IFSA suggested that:

> ...the Government...control the proliferation of regulatory duplication, overlaps and conflicts by legislating to provide a primary set of responsibilities for each regulator and requiring them to rely on regulation by other regulators where they do not have that primary responsibility.[69]

3.80 In evidence IFSA described this arrangement in terms of establishing a 'lead regulator' where two agencies have responsibility over the same area of the law.[70]

---

67 Mr Richard Gilbert, Chief Executive Officer, IFSA, *Committee Hansard*, 24 October 2006, Sydney, p. 98.

68 Mr Richard Gilbert, Chief Executive Officer, IFSA, *Committee Hansard*, 24 October 2006, Sydney, p. 99.

69 IFSA, *Submission 60*, p. 12.

70 Mr David O'Reilly, Policy Director, IFSA, *Committee Hansard*, 24 October 2006, Sydney, p. 98.

3.81 CPA Australia indicated that better cooperation between the regulators is needed:

> ...we had Australian finance services licensing two or three years ago and we have just gone through the two-year transition period for trustee licensing under APRA. There were a lot of the same questions and a lot of the same requirements, although perhaps couched a bit differently. The trustees had to jump through the same hoops again, providing the information to APRA, when a lot of it could have been shared in the first place. Because we have that separation, we end up with a lot of duplication. There does not seem to be as much cooperation between the three regulators as there could be.[71]

3.82 Although calling for an amalgamation of agencies in the long term, AXA suggested a multifaceted approach focusing on improved cooperation in the short term:

> The longer term solution to this issue is to move to a single regulator of financial services, combining the roles currently undertaken by APRA and ASIC. In the medium term, greater differentiation of the roles and responsibilities of the two regulators and a reduction in the amount of dual regulation would be helpful.
>
> In the short term, significant reductions in compliance costs could be achieved through greater co-operation between the regulators and a combined approach by the regulators to their dealing with entities, including:
>
> - co-ordination of regulatory activities and calendars
> - joint conduct of reviews where responsibilities overlap
> - streamlining of policies relating to common areas such as outsourcing, responsible persons/officers and whistleblowing
> - sharing of information and greater co-operation between the regulators.[72]

3.83 The framework for cooperation between ASIC and APRA is set out in their 1998 Memorandum of Understanding (MOU). The provisions of the agreement include:

> A joint Co-ordination Committee will be established to facilitate close cooperation between APRA and ASIC. The Committee will operate according to a Charter and be responsible for ensuring the appropriate arrangements are in place for matters such as co-ordinating information sharing, joint inspections or task forces, referral of cases and enforcement action or major supervisory intervention. It will also co-ordinate operational

71 Mr Michael Davison, Superannuation Policy Adviser, CPA Australia, *Committee Hansard*, 25 October 2006, Melbourne, p. 59.

72 AXA Asia Pacific Holdings, *Submission 45*, p. 12.

> matters such as administrative arrangements to avoid duplication, statistical collections, joint research work or training or industry consultation, and participation in international fora.[73]

And:

> The agencies agree that, subject to legislative provisions, information available to one agency, which is relevant to the responsibilities of the other agency, will be shared as requested. Each agency will provide relevant information to the other on a best endeavours basis, with due regard to the urgency of doing so. This will be subject to any relevant legal and operational considerations and any conditions which the provider of the information might place upon the use or disclosure of the information, such as claims of legal professional privilege.[74]

3.84 On the more specific issue of breach reporting, contributors to the inquiry called for specific legislative change to achieve consistent materiality thresholds and avoid reporting a breach to both APRA and ASIC.

3.85 On materiality, Mercer suggested:

> We recommend that ASIC and APRA work together to develop a standard definition of 'materiality' for the purpose of breach reporting, and implement a streamlined breach reporting process, to minimize compliance costs to the industry.[75]

3.86 The Australian Bankers' Association (ABA) submitted that:

> We support the concept of consistency in breach reporting arrangements, i.e. what must be reported and when it must be reported. However, there should be recognition of the different regulatory objectives and supervisory methods of the two regulators. Therefore, we suggest that a section 912D-type regime be extended to APRA regulated superannuation entity licensing, where requirements align based on significance and materiality. It would be useful for ASIC and APRA to provide procedural guidelines or a checklist.[76]

3.87 It suggested a 'materiality test broadly consistent with the ASIC administered definition of "significant", but with a prudential emphasis'.

3.88 AXA recommended an exemption for trustees from the dual licensing regime to avoid duplication:

> The most effective way to address the cost of dual licensing is to remove the requirement for trustees of public offer superannuation funds to be

---

73 Memorandum of Understanding between APRA and ASIC, October 1998, Paragraph 5.1.

74 Memorandum of Understanding between APRA and ASIC, October 1998, Paragraph 6.3.

75 Mercer Human Resource Consulting, *Submission 71*, p. 21.

76 Australian Bankers' Association, *Submission 88*, p. 18.

> licensed by ASIC to deal in financial products (a minor amendment to Corporations sub regulation 7.6.01(1)(a)). This would eliminate the duplication without reducing the effectiveness of the regulation of these entities. Importantly, a trustee of a superannuation fund would still be obliged to comply with the relevant provisions of the Corporations Act even if it was not licensed under the Corporations Act.

3.89 It added that such a proposal would be workable with requisite co-operation between the regulators:

> Reporting the breach of a Corporations Act requirements [sic] to APRA (as is currently required) will enable effective and efficient regulatory supervision – either directly by APRA or by referral of the breach to ASIC. The mechanism for this co-operation already exists under the Memorandum of Understanding between the two regulators. The failure of the two regulators to co-operate has been the subject of industry criticism, and the duplication of reporting required by the current legislation is evidence of this lack of co-operation.[77]

3.90 APRA informed the committee of legislative change to address inconsistencies in breach reporting requirements.[78] The committee notes that the government has responded to this issue in its December 2006 proposals paper on 'streamlining' prudential regulation.[79] It contains two proposals particularly relevant to the criticisms heard by the committee:

- the inclusion of a materiality test for reporting breaches of prudential regulations, bringing these requirements into line with the test under section 912D of the Corporations Act for reporting breaches to ASIC; and

- legislative amendments to ensure regulatory breaches currently required to be reported to both ASIC and APRA need only be provided to APRA, which would then provide the information to ASIC.[80]

APRA response

3.91 Firstly, the committee notes the government's endeavours to reduce the regulatory burden of overlapping regulatory responsibility through the process currently being undertaken, as mentioned above. However APRA also expressed the opinion that the problem was not of overwhelming significance and that some overlap is necessary, given the legislative arrangements.

---

77 AXA Asia Pacific Holdings, *Submission 45*, p. 13.

78 Mr Ross Jones, Deputy Chairman, APRA, *Committee Hansard*, 7 March 2007, Sydney, p. 102.

79 Treasury, *Streamlining prudential regulation: response to 'Rethinking Regulation'*, December 2006.

80 Treasury, *Streamlining prudential regulation: response to 'Rethinking Regulation'*, December 2006, pp. 1-2.

3.92 APRA told the committee:

> ...when we began the superannuation licensing one of the very first things we did in establishing a process was to get in touch with ASIC to see the extent to which we could use all the information that they collected for their licensing regime. From memory, we found there was only an overlap of 15 to 20 per cent in our population, because many of our licensees are not public companies, so the licensing was different. So for starters we then had to devise our own licensing system.[81]

3.93 It also indicated that with respect to enforcement, involvement by both regulators is be inevitable:

> ...some entities have said, 'Well, we've got APRA and ASIC knocking on our door.' And the answer is, 'Yes, you do, because we deal with different pieces of legislation.' In an enforcement matter it may well be that we are looking at two different types of breaches of different laws. So, yes, APRA enforcement and ASIC enforcement may be there.[82]

Committee view

3.94 The committee does not support merging regulatory agencies to address problems that can be improved substantially through minor legislative amendments and better inter-agency cooperation. It is of the view that the government's proposals to streamline prudential regulation are a positive move to reduce regulatory inefficiency. The proposals referred to above appear to address the same concerns that were most prevalent during the inquiry. As such, the committee recommends that those proposals be implemented through legislation.

Recommendation 7

3.95 The committee recommends that the government's proposed measures to simplify breach reporting be implemented through legislation.

3.96 The committee recognises the strength of feeling in a number of witnesses concerning overlapping, inconsistent and conflicting requirements from a number of regulators. These concerns need to be heeded. The committee is of the view that with respect to APRA and ASIC there are greater advantages to their separate identity as agencies than to their potential amalgamation. However, with respect to their functions the committee has no in-principle objection to functions being reallocated to one or the other, or harmonised in some way. Accordingly, the committee believes that Treasury should report to the government on matters raised in evidence that relate to this issue.

---

81 Mr Ross Jones, Deputy Chairman, APRA, *Committee Hansard*, 7 March 2007, Sydney, p. 110.

82 Mr Ross Jones, Deputy Chairman, APRA, *Committee Hansard*, 7 March 2007, Sydney, p. 110.

Recommendation 8

3.97 The committee recommends that Treasury examine and report to government on the issue of overlapping, inconsistent and conflicting requirements of superannuation funds from a number of regulators.