quietly outperforming.

equipsuper,

30 August 2006

David Sullivan
Committee Secretary
Parliamentary Joint Committee on
Corporations and Financial Services
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
Australia
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Dear Mr Sullivan

Inquiry into the structure and operation of the superannuation industry
Submission by Equipsuper Pty Ltd

Equipsuper Pty Ltd (**Equipsuper**) is pleased to make this submission to the Parliamentary Joint Committee on Corporations and Financial Services in relation to the inquiry into the structure and operation of the superannuation industry.

Equipsuper is a public offer superannuation fund with over $3.7 billion of funds under management. We manage accumulation style accounts and more complex defined benefit entitlements.

If you have any queries in relation to this submission, please do not hesitate to contact Barry Anderson, Company Secretary on (03) 9248 5930.

Yours faithfully

Catherine M Walter
Chairman

EQUIPSUPER PTY LTD

SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

INQUIRY INTO THE STRUCTURE AND OPERATION OF THE SUPERANNUATION INDUSTRY

In preparing this submission, we have adopted the numbering used in the Committee's Terms of Reference.

Executive Summary

Equipsuper agrees that regulation of superannuation needs to be robust given that it is compulsory for many people, entitles members to significant taxation and other legislated benefits and plays an important role in the Government's retirement income policy. Regulation, however robust, must also be efficient and cost effective, consistent with other aspects of Government policy and meet the reasonable expectations of members and other stakeholders.

In summary we make the following submissions:

(a) Uniform capital requirements should not apply to trustees as this would increase costs, reduce competition amongst superannuation funds and would not increase the effectiveness or efficiency of the regulatory regime. The current minimum level of liquid assets for trustees that rely on a custodian to meet the capital adequacy requirements should be retained (section 1).

(b) Trustees of regulated superannuation funds should not be required to be public companies as this would increase the regulatory burden without counterbalancing benefits (section 2).

(c) Superannuation funds should be able to offer other products provided those products generally support the Government's retirement income policy. In particular, the sole purpose test should be amended to permit trustees to offer total and permanent disablement cover to members who have never participated in the workforce (section 3).

(d) The in-house asset rule should be amended to restrict any investment of a regulated superannuation fund to not more than 5% of the market value of fund assets without the approval of APRA (section 3).

(e) The sole purpose test should be amended to permit the cost of financial advice to be deducted from members' superannuation accounts provided that advice is prepared to support the retirement income needs of members (section 4.1).

(f) The *Corporations Act 2001* (**Corporations Act**) should be amended to require financial planning firms to prominently disclose the name of any associated product provider in all material provided to consumers (section 4.2).

(g) Legislative changes should be introduced to permit employers who fund defined benefit entitlements to be offered investment choice as is currently available to members (section 5).

(h) Since competition between superannuation funds is effective and members have access to independent advice, trustees should not be responsible for investment choices made freely by members (section 6).

(i) All legislative amendments should take into consideration any impact on defined benefit entitlements so as to provide clarity and reduce compliance costs incurred by trustees (section 8).

(j) The dual regulatory regime should be replaced by a single regulatory authority responsible for consumer protection and prudential regulation of regulated superannuation funds (section 9).

(k) If the current funding arrangement for prudential regulation is maintained, superannuation funds should be able to contribute to the development of pertinent regulatory issues. Trustees should also be rewarded for good corporate behaviour through a reduction in their levy (section 10).

(l) Superannuation funds should be permitted to engage in promotional advertising since economies of scale through increased membership can reduce costs for members (section 11).

(m) Superannuation funds that do not distribute operating surpluses to shareholders or external parties should be able to use the terms “not for profit” and “profits to members” (section 12).

(n) Any proposal to benchmark Australia against international practice should include issues such as the level of mandatory contributions, the relative size of investment markets, the regulatory environment and taxation concessions (section 13).

(o) Trustees should not be required to fund financial assistance provided to other superannuation funds where compensation has been paid due to a failure of the regulatory regime (section 14).

(p) The equal representation rule should be amended to permit trustees to appoint more independent directors (section 15.1).

(q) Public offer funds should not be prohibited from merging or accepting other funds with an existing self-insurance exposure (section 15.2).

(r) Capital gains tax rollover relief should be extended to all fund mergers or successor fund transfers (section 15.3).

1. Whether uniform capital requirements should apply to trustees

1.1 Background

Currently, public offer funds must:

- maintain a minimum of $5 million in net tangible assets;
- have an approved guarantee for $5 million;
- have a mix of net tangible assets and an approved guarantee totaling at least $5 million; or
- arrange for the assets of each registrable superannuation entity under its trusteeship to be held by a custodian in accordance with requirements agreed with the Australian Prudential Regulation Authority (**APRA**)[1].

Where a trustee relies on a custodian to meet the capital adequacy requirements, APRA also requires a minimum level of liquid assets (that is, cash and cash equivalents) to be maintained. This condition has been imposed to offer protection against risks arising from operational activities (such as in-house administration). Currently, the minimum level of liquid assets has been set at $100,000 but may be higher depending on the trustee's activities.

1.2 Comment

We acknowledge the strong public interest in the secure operation of regulated superannuation funds but submit that the imposition of a uniform capital requirement would neither increase the efficiency of the superannuation industry, nor enhance safety of the regulatory regime for members. The regulatory regime must continue to be flexible in order to accommodate the different types of superannuation vehicles available to the public, ranging from self-managed superannuation funds to extended public offer funds. This also has the effect of promoting competition and ultimately containing costs. The imposition of a uniform capital requirement would adversely impact the 'mutual' superannuation sector,[2] which represent a viable alternative to the superannuation product offerings of financial institutions.[3]

[1] Trustees of small APRA funds cannot use an independent custodian to meet the capital requirements.
[2] Currently comprising stand-alone corporate and industry funds.
[3] We refer to a research paper entitled "The Investment Performance of Australian Superannuation Funds" published by APRA in February 2003 which demonstrated that the average return on assets for retail funds over the period 1996-2002 was 4.51%, as compared with 5.82% for industry funds. The statistics published by APRA for the quarter ended December 2005 show that, although retail funds generated a return on assets of 3.3% for the quarter (while industry funds generated a return on assets of 3.2% for the quarter), for each of the preceding quarters, the return on assets of industry funds surpassed the return on assets of retail funds.

Also, we would not support a proposal to increase the minimum level of liquid assets currently imposed on public offer funds that appoint an independent custodian. A trustee should be given the flexibility to determine the level of operational reserves necessary to meet the business needs of the fund. The present disclosure regime already requires the value of reserves, to the extent that they fall within the concept of "common fund" under the Corporations Act, to be disclosed.

Although it could be argued that larger mandatory reserves offer greater protection to members against operational risks and errors, reserves come at a cost. This is irrespective of whether this is achieved through external capital, withholding returns or an increase in fees and charges to members (the only option for not-for-profit funds).

Part of the need for capital can be addressed by holding insurance. Public offer fund trustees are already required to maintain trustee liability insurance which includes professional indemnity cover. Professional indemnity cover is available for the major risks faced by trustees, including employee fraud and administrative error.

Recommendation: Uniform capital requirements should not apply to trustees as this would increase costs, reduce competition amongst superannuation funds and would not increase the effectiveness or efficiency of the regulatory regime. The current minimum level of liquid assets for trustees that rely on a custodian to meet the capital adequacy requirements should be retained.

2. Whether all trustees should be required to be public companies

2.1 Background

A trustee of a regulated superannuation fund must either be a constitutional corporation or its governing rules must provide that the sole or primary purpose of the fund is the provision of old-age pensions. A proprietary company limited by shares is the most common form of company structure that is used as the corporate trustee of a superannuation fund.

2.2 Comment

Where trustees of regulated superannuation funds intend to engage in public fundraising, then they must be public companies. Otherwise we see no need for trustees to be public companies and question what additional protection this would provide, given the 'fit and proper' standards recently introduced by the superannuation licensing regime. This additional layer of regulation for the trustee company itself would create a substantial cost overhead to be borne ultimately by members, which is not justified given the current level of prudential regulation.

Recommendation: Trustees of regulated superannuation funds should not be required to be public companies as this would increase the regulatory burden without counterbalancing benefits.

3. The relevance of Australian Prudential Regulation Authority standards

3.1 Background

We propose to comment on the APRA standards in relation to the operation of the sole purpose test and the in-house asset rule. These standards reinforce the Government's policy of supporting 'self-sufficiency' in retirement and seek to protect against the abuse of its 'subsidy' of retirement savings through the grant of taxation concessions.

The sole purpose requirements contained in section 62 of the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**) limit the provision of superannuation benefits by regulated superannuation funds to a range of prescribed retirement or retirement related circumstances (known as 'core' and 'ancillary' purposes). APRA also has the power to approve other ancillary purposes under section 62 of the SIS Act. The sole purpose test reflects the fact that the fundamental purpose of superannuation is to provide for retirement.[4]

Part 8 of the SIS Act sets out the in-house asset rule which limits a regulated superannuation fund from investing more than 5% of the market value of the fund's assets in "in-house assets". This rule originated as a measure to ensure the *bona*

[4] The sole purpose test also appeared in s 3 of the *Occupational Superannuation Standards Act 1987* and has been a tool employed by regulators to prevent abuse of tax concessions through the establishment of funds with no real intention of providing retirement benefits for employees: see, eg, *FCT v Roche* 891 ATC 5024.

fides of employer-sponsored superannuation by preventing more than a certain percentage of the fund's assets from being invested in, or lent to, the employer sponsor and its associates.[5]

3.2 Comment

<u>*Sole purpose test*</u>

We submit that the sole purpose test as prescribed in section 62 of the SIS Act and APRA's circular[6] should be amended in light of the changing environment of the superannuation industry.

Superannuation funds are currently prohibited from enhancing their product offerings due to the limitation of the sole purpose test. This is best demonstrated by an example. Equipsuper recently sought to offer total and permanent disablement cover to members who are not employed. Such a product would be of particular interest to women who choose to take unpaid leave to raise their family. APRA initially refused to grant us authority to offer this product on the basis that it would be in breach of the sole purpose test. The issue was that a member could be found to be totally and permanently disabled (**TPD**) because they could not undertake certain activities of daily living, rather than because they could no longer work. We were subsequently permitted to offer the product but subject to the limitation that the member must have previously been employed.

We submit that superannuation funds should be able to offer other products provided those products generally support the Government's retirement income policy. Such a policy should encourage people to provide for their own and their family's well-being whether they retire due to old age or ill-health.[7]

The nexus between superannuation and employment has weakened over time.[8] A spouse can now hold a superannuation account despite never having joined the workforce. However, such a spouse who has never participated in the workforce cannot purchase TPD cover through his or her superannuation fund even though there are sound public policy reasons for permitting such a product to be offered.

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[5] The 'Maxwell scandal' in the United Kingdom is an example of the threat to retirement savings through investment in an employer group that collapses: see Arie Freiberg, 'Bang Bang Maxwell's Silver Hammer? Superannuation Crime in the 1990s' (1996) 24 *Australian Business Law Review*, 217

[6] Australian Prudential Regulation Authority, Superannuation Circular No.III.A.4, The Sole Purpose Test, February 2001.

[7] This might even extend to permitting superannuation funds to pay health insurance premiums.

[8] Arguably, the introduction of 'choice of fund' requirements has broken the employment nexus and transformed superannuation into more of a voluntary investment, albeit underpinned by the Government's retirement income policy.

We also note the inconsistency in the way salary continuance cover is regulated. Such insurance cover can be offered by superannuation funds provided that the period of cover is no more than two years. There is no such constraint if salary continuance cover is purchased outside of superannuation, that is, either directly by the member or funded by the member's employer. As superannuation funds are often better placed to negotiate lower premiums for their members, we submit that the current restriction placed on superannuation funds be removed.

The extent to which superannuation funds are able to offer members financial advice is also limited by the sole purpose test. (Please refer to our comments in section 4 below.)

In-house assets

For multi-employer funds like Equipsuper that invest directly in securities, the current provisions of the in-house asset rule has unintended consequences due to the wide application of the term "related party".

As an illustration, when a Federal Government entity joined Equipsuper as a participating employer, we were in technical breach of the in-house asset rule as our exposure to Australian Government bonds exceeded 5% of the market value of the fund's assets. After extensive discussions with APRA, we were able to obtain relief for those specific circumstances.

Under the choice of fund regime, an in-house asset exposure may be easily created for multi-employer funds when an employee of a listed public company elects to join the fund. Although the exposure is unlikely to be in excess of 5% of fund assets, it imposes a continuous obligation on trustees to monitor the employment position of all members, an obligation that no trustee can comply with cost-effectively. This obligation exists even when a trustee appoints a fund manager who only invests on arms' length terms.

Although we support the basis upon which the in-house asset rule was introduced, we submit that a rule which is relevant to corporate funds with a small number of participating employers is unworkable for a large multi-employer fund, where the 'mischief' sought to be avoided is remote. For large multi-employer funds the application of the in-house asset rule is not consistent with the intended policy position.

In light of the above, we would support legislative changes to restrict any investment of a regulated superannuation fund to not more than 5% of the market value of fund assets without the approval of APRA.

Recommendation: Superannuation funds should be able to offer other products provided those products generally support the Government's retirement income policy. In particular, the "sole purpose" test should be amended to permit trustees to offer total and permanent disablement cover to members who have never participated in the workforce.

The in-house asset rule should be amended to restrict any investment of a regulated superannuation fund to not more than 5% of the market value of fund assets without the approval of APRA.

4. The role of advice in superannuation

4.1 Paying for the cost of advice

(a) Background

We submit that the role and regulation of financial advice to superannuation members is critical to the effectiveness and safety of the industry given the compulsory nature of superannuation, the importance of asset allocation in achieving investment goals and the complexity of the overall regulatory and taxation environment. Arguably, how one's superannuation assets are invested is the second most important investment decision after the purchase of the family home. Therefore, it is very important that members are able to access sound, unbiased and cost effective financial advice.

Currently, APRA will only permit the cost of financial advice in relation to a member's specific superannuation interest to be deducted from his or her account balance. This is based on the premise that financial advice in relation to non-superannuation investments would not be within the parameters of the sole-purpose test[9].

[9] See comments in section 3.

(b) Comment

As upfront fees are not always within the reach of all members, we propose that the cost of broader retirement planning advice be permitted to be deducted from a member's superannuation account balance.

A financial adviser preparing a full financial plan must consider all the assets and liabilities of his or her client. We submit that the whole cost of such a plan (pre-agreed with the member) should be able to be deducted from a superannuation account provided it is being prepared to support the retirement income needs of the member.

We would also argue that such a position would create a level playing field with superannuation products offered through a commission-based structure. Most financial institutions pay commissions to financial advisers out of the fees they charge to the superannuation fund member. These fees can be negotiated between the financial adviser and the member, depending on the level of commission the adviser is prepared to accept from the financial institution. This is a common way of 'paying for' financial advice, without the member being 'out-of - pocket' upfront. Often these commission structures provide for an ongoing 'trail' commission to be paid to the adviser, regardless of whether any ongoing advice service is provided. In many cases the ongoing advice service is non-existent or minimal, yet the trail commission is charged on a percentage of the member's assets with a compound negative impact over time.

Our modest proposal to allow a fixed fee for retirement planning to be deducted from a member's superannuation account balance would provide a viable alternative for members to obtain financial advice without impacting the long-term growth of their retirement savings through the erosive effect of trailing commissions.

Recommendation: The sole purpose test should be amended to permit the cost of financial advice to be deducted from members' superannuation accounts provided such advice is being prepared to support the retirement income needs of members.

4.2 Disclosure of associations and relationships

(a) Background

Financial Services Guides (**FSG**) are required to disclose information about any associations or relationships between the financial adviser and the issuers of any financial products, being associations or relationships that might reasonably be expected to be capable of influencing the financial adviser in providing any of the authorised services.[10] This requirement seeks to protect consumers by ensuring that they are fully aware of potential conflicts of interest.

(b) Comment

We submit that disclosure of associations or relationships in a FSG does not go far enough in protecting consumers. The associated product provider's name should also be required to be used in immediate connection with the name of the financial planning firm.

As an example, if a car buyer visits a Holden or Ford dealer they do so with the expectation that they will be recommended to buy a car manufactured by that company. The difference for consumers of financial advice is that they may not always be able to easily identify upfront those products they would expect to be recommended.

> **Recommendation:** The Corporations Act should be amended to require financial planning firms to prominently disclose the name of any associated product provider in all material provided to consumers.

5. The meaning of member investment choice

5.1 Background

Under the SIS Act trustees are responsible and accountable for the management of the fund's investments. Under section 52(2)(f) of the SIS Act the trustee has a duty to formulate and implement an investment strategy or strategies, having regard to a range of factors. Section 58 of the SIS Act provides that the governing rules of a superannuation entity must not permit a trustee to be subject, in the

[10] Corporations Act, s 942C(2)(g).

exercise of any of the trustee's powers under those rules, to direction by any other person. This prohibition is modified by section 52(4) of the SIS Act to permit members to give the trustee investment directions, in specified circumstances.[11]

5.2 Comment

We believe the current regulatory framework within which members are permitted to give trustees directions as to the investment strategy of particular assets should be extended to include employers who fund defined benefit entitlements. There are sound reasons why an employer may want to vary from the trustee's standard defined benefit investment option. For example, where a company is expecting a significant proportion of employees to leave employment, there may be good reasons to minimise any exposure to the volatility of investment markets.

The extension of investment choice to employers is also consistent with their treatment under the Corporations Act. For example, under financial services regulation an employer must be given a product disclosure statement[12] and also has 'cooling off' rights.[13]

> **Recommendation:** Legislative changes should be introduced to permit employers who fund defined benefit entitlements to be offered investment choice.

6. The responsibility of the trustee in a member investment choice situation

6.1 Background

APRA recently revised Superannuation Circular No.II.D.1 "Managing Investments and Investment Choice" which provides guidance to trustees in complying with section 52 of the SIS Act. This revised circular limits the investment choices available to members by imposing on trustees an obligation to monitor the amount or proportion of a member's investment in a particular strategy. It has been suggested by APRA that trustees cannot abrogate responsibility in relation to investment strategies[14] by requiring members to seek their own financial advice.

[11] See also SIS Act, s 58(2)(d).
[12] Corporations Act, s 1012I.
[13] Corporations Act, s 1019B, as modified by reg 7.9.68.
[14] See SIS Act, s 52(2)(f).

The revised circular also suggests that a trustee may require members to hold a minimum of five separate stocks, if single equities are offered as investment options. Where members are solely or heavily invested in narrow or risky options, APRA has suggested that trustees could provide "health" warnings to such members. Other options include the ability to rebalance member's investments.

6.2 Comment

Firstly, superannuation will, for many individuals, form only part of their investment strategy and members should be permitted to make investment choices based on their circumstances in totality. If members seek independent financial advice, they should not be subject to further review by the trustee.

An example would be where the family home is also viewed as an asset that can be used for retirement purposes, whether that is achieved through disposal and "downsizing" or the use of reverse mortgage style products. There has also been significant growth in the number of Australians who are direct shareholders. Although such assets may fall outside the superannuation environment, they still form part of an individual's investment portfolio.

Given the range of non-superannuation assets members may invest in and the fact that many members maintain multiple superannuation accounts, it is impractical for a trustee to be responsible for investment choices of its members. Although it may not be prudent for an individual to invest a substantial part of his or her superannuation account balance in a single asset class, such a decision may be entirely sensible for another member who holds a significant investment portfolio outside the superannuation environment.

Secondly, not all trustees are licensed to provide financial advice, therefore, any ongoing monitoring which trustees are required to implement may be in breach of the licensing requirements under the Corporations Act.

The views expressed by APRA in the revised circular would appear to be contrary to the policy reasons in support of the choice of fund regime. If investors are permitted to choose their superannuation fund, why are we now imposing restrictions on the types of investments they are permitted to select?

Finally, we note that the views expressed by APRA seek to convert the trustee's duty of prudent investment into an individual duty of care. This fundamentally misconstrues the nature of the trustee's role in a collective investment scheme, which is to act in the best interests of members as a whole[15] and to act impartially as between individual members and fairly as between groups of members.[16] It also undermines the intent of section 52(4) of the SIS Act, which provides that an investment strategy is deemed to comply with the section 52(2)(f), if a member gives specific directions to the trustee about the strategy to be followed in relation to the investment of his or her account balance.

We submit that provided any default investment options offered to members are diversified and comply with section 52(2)(f) of the SIS Act, trustees should not be responsible for the individual investment choices made by members.

Recommendation: Trustees should not be responsible for investment choices made freely by members provided that the default investment option is a diversified strategy.

7. The reasons for the growth in the self managed superannuation funds

No comment

8. The demise of defined benefit funds and the use of accumulation funds as the industry standard fund

8.1 Background

Defined benefit funds comprise a significant part of our business. The cost and complexity of administering defined benefit entitlements is often overlooked by the legislator, as well as, the regulator.

For example, the recently introduced enhanced fee disclosure requirements sought to adopt a fee template designed for accumulation style accounts to all superannuation products. Product disclosure statements for defined benefit funds

[15] See, eg, *Cowan v Scargill* [1985] Ch 270.
[16] *Edge v Pension Ombudsman* [2000] Ch 602, 630.

are required to include the standard fee template but with the various fee categories labeled as “nil”.

Further, the requirement that fees and charges be disclosed in the same section of the product disclosure statement has limited the flexibility of using statements in multiple parts. This has been necessary for those defined benefit products where members are also offered accumulation top-up accounts which is dealt with in a separate part of the product disclosure statement.

Similar problems have been experienced by defined benefit funds in complying with the enhanced fee disclosure regime as it applies to periodic statements.

8.2 Comment

Although the number of open defined benefit funds is rapidly declining, investment in them still represents a significant part of the superannuation entitlements of many members. Amendments to superannuation legislation are often finalised without apparent careful consideration of the impact on defined benefit entitlements. This adds to compliance costs as trustees are required to lobby for legislative refinements.

Recommendation: All legislative amendments should take into consideration any impact on defined benefit entitlements so as to provide clarity and reduce compliance costs incurred by trustees.

9. Cost of compliance

9.1 Comment

Equipsuper holds an Australian financial services licence, as well as a public offer licence issued by APRA. Although we appreciate the importance of consumer protection and prudential regulation within the superannuation industry, the dual regulatory environment adds significantly to the cost of compliance. The cost has not been limited to the application for new licences but also in the maintenance of those licences, as well as managing the expectations of separate regulators.

For example, superannuation trustees are required under both the SIS Act and the Corporations Act to report breaches to APRA and the Australian Securities and

Investments Commission (**ASIC**) respectively. However under the Corporations Act, only significant breaches must be reported. In contrast, no materiality test is applied to those breaches which must be reported to APRA. Therefore, trustees must adopt different rules when reporting breaches to regulators.

Under the SIS Act[17] trustees are required to notify APRA within 14 days of a breach of a licence condition. It is a licence condition for licensees to comply with "RSE Licensee Law". The term "RSE Licensee Law" is defined to include, amongst other things, certain provisions of the Corporations Act applicable to trustees of superannuation funds. As a result, a breach of the Corporations Act may trigger a reporting requirement to ASIC which is subject to a "significance test" and a reporting requirement to APRA.

We also note that the two regulators have different operating styles. APRA assigns a nominated manager to each trustee who becomes familiar with the products and capabilities of the trustee being supervised. ASIC, on the other hand, assigns a different analyst to each matter, which means that trustees are required to explain the background of the fund to each analyst it deals with. This is particularly onerous for Equipsuper as we manage a large number of complex defined benefit plans.

While we acknowledge that the focus of each regulator is necessarily different (since APRA is a prudential regulator, while ASIC is a disclosure and conduct regulator), we submit that the dual regulatory infrastructure should be reconsidered. If the current system of dual regulation is retained, then we submit that consistent approaches should be adopted by both regulators as far as possible.

Recommendation: The dual regulatory regime should be replaced by a single regulatory authority responsible for consumer protection and prudential regulation.

[17] Section 29JA the SIS Act.

10. The appropriateness of the funding arrangements for prudential regulation

10.1 Background

The *Superannuation Supervisory Levy Imposition Act 1998* provides for the funding of prudential regulation through levies imposed on superannuation funds.

10.2 Comment

Although on balance we consider the current arrangements appropriate, participants in the superannuation industry should have input into pertinent regulatory issues if this funding arrangement is maintained. If superannuation funds are not able to contribute to the development of regulatory processes, the funding of prudential regulation should be through consolidated revenue.

Currently the levy is only based on a superannuation entity's asset value. We submit that trustees should be rewarded for good corporate behaviour through a reduction in the applicable levy.

Recommendation: If the current funding arrangement for prudential regulation is maintained, superannuation funds should be able to contribute to the development of pertinent regulatory issues. Trustees should be rewarded for good corporate behaviour through a reduction in their levy.

11. Whether promotional advertising should be a cost to a fund and, therefore, to its members

11.1 Comment

There are currently limitations placed on regulated superannuation funds participating in promotional advertising due to the sole purpose test. This has created a disparity between "for profit" and "not for profit" superannuation funds. Those superannuation organisations that operate on a "for profit" basis have the ability to fund promotional costs through shareholders or access it through other parts of the corporate group. Although this is within the boundaries of the sole purpose test, in reality fund members do pay for such costs through increased fees in order to achieve the desired return on equity shareholders ultimately demand.

The main objective of promotional advertising is to maintain funds under management. Such an objective is in the best interest of members generally, as it seeks to reduce the overall operational costs for all members through the generation of economies of scale. This can be seen in many parts of the financial services industry and equally apply in the superannuation industry, through the reduction of management expense ratios (and fees).

Therefore, funds should not be prohibited from engaging in promotional marketing or advertising. Where such costs are a cost to the fund, it is more of a disclosure than a prudential issue. If a fund's fees were to increase significantly due to undisciplined promotional costs, members would 'vote with their feet' in a choice of fund environment. It is therefore an issue of market choice, not regulatory constraint.

Recommendation: Superannuation funds should be permitted to engage in promotional advertising as economies of scale through increased membership can reduce costs for members.

12. The meaning of the concepts "not for profit" and "all profits go to members"

12.1 Comment

We would argue that the phrase "not for profit" is widely understood to mean an organisation in which no shareholder or external party is entitled to the profits or operating surplus generated by that organisation. We believe the phrase "all profits go to members" was introduced by those "not for profit" entities who wanted to assert that their business practices were as sound as those of a profit-making entity. We further believe that members appreciate the differences between such organisations and profit-making entities.

We acknowledge that it is difficult to capture the essence of a business in a simple phrase. If the term "profit" is strictly defined as the operating surplus equal to the difference between revenue and costs, then very few organisations would fall within the definition of "not for profit". This is because it is inevitable that revenue exceeds costs, from time to time. Any such surpluses would be transferred to reserves for those times when costs exceed revenue.

A superannuation fund that generates internal surpluses or maintains reserves which are used for operational purposes, should not be prohibited from being considered a "not for profit" fund as such surpluses or reserves are retained for members. The term "all profits go to members" is also true for funds that only provide accumulation style benefits where all expenses are paid by members.

Equipsuper provides both defined benefit and accumulation style benefits. We do not consider that the term "all profits go to members" accurately reflects our business as internally generated surpluses may mitigate future increases in fees funded by defined benefit employers, as well as, other members. The term "profits for members" better describes the structure of Equipsuper.

Recommendation: Superannuation funds that generate internal surpluses or maintain reserves should not be prohibited from using the terms "not for profit" and "all profits go to members".

13. Benchmarking Australia against international practice and experience

13.1 Comment

We would support any initiative to benchmark Australia against international practice and experience. However, we note that differences in the regulatory environment, the size of regulated entities and the markets within which they compete may make this difficult. If benchmarking is adopted it should consider a wide range of factors, including administrative and investment performance, the level of contributions to superannuation, prudential regulation, as well as, taxation issues. This is particularly important since most overseas regimes do not have a mandatory superannuation component and may not offer comparable tax concessions.

Recommendation: Any proposal to benchmark Australia against international practice should include issues such as the level of mandatory contributions, the relative size of investment markets, the regulatory environment and taxation concessions.

14. Level of compensation in the event of theft, fraud and employer insolvency

14.1 Background

The *Superannuation (Financial Assistance Funding) Levy Act 1993* provides for the imposition of levies on regulated superannuation funds to recover compensation paid by the Government under the SIS Act for theft and fraud in superannuation funds.

14.2 Comment

Where compensation has been paid by the Government due to a failure of the regulatory environment, we query why members in the rest of the industry should be adversely affected?

Recommendation: Trustees should not be required to fund financial assistance provided to other superannuation funds where compensation has been paid due to a failure of the regulatory regime.

15. Any other relevant matters

15.1 Corporate Governance

(a) Background

The SIS Act currently requires the trustee of a public offer fund to either be an independent trustee or comply with the equal representation rule. The equal representation rule limits the number of independent directors that are permitted on the board.

Equipsuper is a public offer fund and continues to comply with the equal representation rule. However, unlike almost all other profit for member superannuation funds, all directors except the Chairman are elected by participating employers or members. Although we believe that members should have appropriate representation, the current application of the equal representation rule by APRA is inflexible and limits the pool of experienced directors.

(b) Comment

Equipsuper considered changing its structure to increase the number of independent directors so as to enhance the mix of skills and experience of the Board. Although we believe that such a change would be in the best interests of all members, our preliminary discussions with APRA suggest that such a change would not be supported by the regulator.

The equal representation rule should be amended to permit the appointment of more independent directors in light of the obligations on licensees to comply with standards relating to the fitness and proprietary of trustees.

Recommendation: The current application of the equal representation rule by APRA is inflexible and limits the pool of experienced directors. The rule should be amended to permit trustees to appoint more independent directors.

15.2 Self-insurance

(a) Background

Under our RSE licence the provision of any benefits that are life insurance (including disability) benefits to members must be wholly determined by reference to life policies issued to the trustee from a company registered under the *Life Insurance Act 1995*. We have, however, obtained exemptions from APRA in relation to our self-insurance[18] exposure as at the date the licence was issued.

All Equipsuper accumulation members are externally insured. Defined benefit members are externally insured if appropriate cover can be purchased. Equipsuper has a self-insurance exposure for old claims and if insurers do not offer the cover required, for example, in respect of some occupations.

When a fund is transferred on a successor fund basis there is always the risk of a self-insurance exposure, where the fund was at any time self-insured or the definition of "total and permanent disablement" in the trust deed is at variance with that contained in the relevant insurance policy. Moreover, we are often unable to

[18] The term "self-insurance" is used here to mean insurance that is not provided by an insurance company registered under the *Life Insurance Act 1995*. The cost of "self-insurance" is ultimately funded by the relevant employer.

determine the extent of any self-insurance exposure, if any, until some time after the transfer date.

(b) Comment

APRA's view on self-insurance is a significant barrier to further consolidation within the industry. We submit that public offer members are not adversely affected by any self-insurance exposure of a multi-employer fund as the risk is quarantined to the relevant employer's sub-plan. Further, it is an issue that can be managed through actuarial reviews.

Recommendation: Public offer funds should not be prohibited from merging or accepting other funds with an existing self-insurance exposure.

15.3 Consolidation of funds

(a) Background

During the transitional period for the implementation of the new APRA licensing regime, superannuation funds were granted capital gains tax rollover relief upon the implementation of a successor fund transfer.

(b) Comment

Although the transitional period for the new licensing regime has expired, the industry continues to consolidate albeit at a slower rate. We submit that capital gains tax rollover relief should be extended to all fund mergers or successor fund transfers to facilitate future industry consolidation.

Recommendation: Capital gains tax rollover relief should be extended to all fund mergers or successor fund transfers.

Equipsuper Pty Ltd

30 August 2006