

31 August 2006

The Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir,

Inquiry into the Structure and Operation of the Superannuation Industry

Asteron, the financial services arm of the Promina Group, is pleased to have the opportunity to provide comment to the Inquiry into the Structure and Operation of the Superannuation Industry.

Asteron has a long history of operating in Australasia, with roots tracing back to 1833 in Australia and to 1878 in New Zealand. Formerly Royal & SunAlliance Financial Services, the company changed its name to Asteron on 1 July 2003.

Today Asteron's key business activities include life insurance, superannuation, retirement incomes and financial planning. Asteron's market leading suite of financial products is offered through a broad network of financial advisers, including the fully owned financial planning groups, Guardian Financial Planning and Cameron Walshe.

As at December 2005, almost one million customers across Australia and New Zealand entrust Asteron with approximately \$9.1 billion in funds under administration and almost \$28.7 billion in funds under supervision. Asteron has around 1,200 staff in 22 offices throughout Australia and New Zealand.

Asteron is owned by the Promina Group, a portfolio of specialised and focused insurance and selected financial service businesses including well-known brands such as AAMI, Vero, Shannons, Tyndall and Australian Pensioners Insurance Agency (APIA).

The Promina Group listed on the Australian and New Zealand stock exchanges in May 2003. It is one of the top 50 companies in Australia and top 20 in New Zealand by market capitalisation. As a member of this family, Asteron enjoys substantial financial stability and security and can draw on over 170 years of experience in financial services.

In reviewing the terms of reference for this Inquiry, we have chosen to concentrate on the following reference points:

1. Whether uniform capital requirements should apply to Trustees.
3. The relevance of APRA standards.
4. The role of advice in superannuation.
5. The meaning of member investment choice.
6. The responsibility of the Trustee in a member investment choice situation.
9. Cost of compliance.
11. Whether promotional advertising should be a cost to a fund and, therefore, to its members.
12. The meaning of the concepts "not for profit" and "all profits go to members".

We believe this is an important inquiry as it can help to identify the value of advice and highlights the differences between Trustee prudential management and individual member advice. This inquiry brings value to the superannuation industry as it also identifies areas that require improvement.

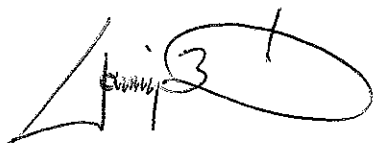
In summary our recommendations are:

- risk-based capital requirements for Trustees
- review SIS legislation and APRA Standards to ensure they continue to acknowledge changes in legislation and to capture the complexities of superannuation
- recognise the value of financial advice
- allow Trustees to take into account financial advice received by a member from a qualified Financial Adviser
- simplify advice regulations to reduce the cost of providing advice
- ensure consistency in the calculation and disclosure of fees and returns
- the use of non-profit or not-for-profit terms need separation of services from trustee activities.

Asteron is pleased to have the opportunity to comment on these important issues and would be happy to provide any further information related to the matters outlined in the attached submission.

Should you require any further information or wish to discuss the content of this submission, please feel free to contact Louise Biti, Head of Technical Services on 02 8275 3472.

Yours sincerely



per Dennis Fox
Chief Executive Officer
Promina Financial Services

**Parliamentary Joint Committee on Corporations & Financial Services
Submission by Asteron**

Whether uniform capital requirements should apply to Trustees

Asteron supports the application of risk-based capital requirements for Trustees of superannuation funds. The size and nature of the superannuation industry requires a high level of public confidence. Inadequate capital adequacy requirements could undermine this confidence if problems arise, as well as destroy the retirement plans of many Australians.

This requirement would also answer the second point of the Terms of Reference for this Committee – whether all Trustees should be required to be public companies. Trustees do not need to be public companies, as long as they are adequately capitalised.

Recommendation: Risk-based capital requirements are recommended for Trustees.

The relevance of Australian Prudential Regulatory Authority (APRA) standards

Superannuation is becoming the second largest asset that Australians will own, after their home. This is largely facilitated through the compulsory employer superannuation guarantee contributions. It is therefore critical that a robust regulatory environment is in place to ensure prudential management of Australians' retirement savings.

It is acknowledged in an APRA report¹ that superannuation has traditionally been offered under a trust structure due to its origins in the employer/employee context. This allowed for the separation of assets of an employer from those ultimately belonging to the employees (to safeguard these assets) and to ensure the management of these assets was conducted in the best interests of the employees.

APRA standards focus on the management of superannuation funds and the role of Trustees to create a stable superannuation environment. Superannuation law is based on trust law which ultimately makes the Trustee accountable for the prudent management of the fund assets and responsible to ensure that all decisions made by the Trustee take into account the best interests of the beneficiaries (on an individual and a group basis). However, some aspects around member choices distinguish the superannuation environment from many other trust arrangements where beneficiaries have less control and choice.

It should also be noted that superannuation funds have been subject to increasing regulation in past years, which are reflected in the constant changes in the Superannuation Industry (Supervision) Act and Regulations (SIS) as well as the Financial Services Act and Regulations (FSR).

¹ *APRA and the Financial System Inquiry* – Working Paper 3, Goldworthy, Lewis and Shuertrim, January 2000.

Superannuation funds, except for self-managed superannuation funds (SMSFs) have developed into highly complex and large trust funds where members now have a choice to belong or to move to another fund. Therefore members have more flexibility in directing the Trustee where they want their superannuation benefits held or in advising the Trustee what investment strategy best suits them. This should alleviate Trustees from the responsibility to make decisions for individual members, where investment choice has been directed by the member.

Recommendation: APRA standards should consider the constantly changing superannuation environment and the impact in relation to trust law. It is recommended that the APRA standards be updated regularly to keep the Trustee fully informed. Furthermore, appropriate standards/circulars should be provided to capture the large complex area of superannuation.

The role of advice in superannuation

Many Australians have not taken an active involvement in their superannuation. They have been passive participants in the accumulation of their retirement savings. This is starting to change, largely driven by education programs and legislative changes such as 'Choice of Fund'.

With longer life expectancies, earlier retirement ages and the cost of raising families being carried into older ages (due to increases in the average age for starting a family), many Australians will have a large retirement savings gap when they reach retirement.

Superannuation is a highly complex area - a reason why many Australians do not make active choices. The general lack of understanding of superannuation rules and how to gain the best value means that without professional financial planning advice, superannuation is not used by the majority of consumers to its full potential.

This is compounded by the general lack of awareness about the extent of the savings gap problem with a false sense of security that superannuation guarantee (SG) will be adequate to fund retirement. Financial advice can help clients understand the need to contribute to their savings and establish plans to achieve the outcomes a client requires.

The role of advice is to provide clients with strategies to meet their needs and objectives at varying life stages. Advice is a holistic concept and the recommendation of products is the end result from this process. The value of advice should be seen and promoted more widely than a focus on superannuation, but we note that this Committee is limited to issues within superannuation. However, in noting this, while a Financial Adviser will consider the client's full circumstances, the Trustee of a superannuation fund does not have this capacity. The Superannuation Circular II.D.1 indicates that a Trustee should not take circumstances outside the superannuation fund assets into account, even though the industry enforce (through FSR) the importance of consideration to a client's full circumstances when advice is given (from an adviser).

Advice in super is more than just selecting a fund and an investment strategy. This is just the starting point. Advice also may cover:

- eligibility rules to contribute
- types of contributions and limits
- nominations and strategies for death benefits
- options for insurance cover
- integration of superannuation into the full investment portfolio.

The government has undertaken a number of campaigns to increase consumer awareness and engagement, including the recent launch of the Literacy Foundation. The Government regulators should more actively promote the importance of advice and especially in relation to superannuation. Inadequate financial advice and planning or indeed a lack of advice can result in dramatically reduced retirement benefits for Australians.

Most people do not make conscious and informed decisions without the assistance of professional advice. In fact, the majority of clients who do not seek financial planning advice merely invest in the default investment option already set up for their fund. While these investment options may have sound investment strategies, they may tend to be quite conservative and may not allow a client to maximise the full potential for their savings.

As the average balance of a person's superannuation grows, so does the need for professional advice. But advice is still needed at all levels, especially in relation to protecting wealth through insurance and protecting estates through death benefit nominations.

The role of a Financial Adviser is to develop an individual strategy in conjunction with coaching the client on how to meet their needs and objectives to match them to sound wealth accumulation strategies across their full portfolio. These strategies are developed in consultation with the clients and with the client's full agreement.

Advice is more heavily regulated now under FSR than when SIS standards were first implemented. The industry has also increased in professionalism and ability to service individual clients. The advice provided by an Adviser is clearly documented in a Statement of Advice (SOA) and must be relevant to the client. Trustees should be able to accept this advice as an appropriate investment strategy for a client. The advice process takes into consideration the needs, objectives, timeframe and investment experience of clients and matches an appropriate strategy to these attributes. These are attributes that the Trustee of a superannuation fund is not able to consider on an individual client basis. A Financial Adviser can "know a specific client" while the Trustee can only understand generic assumptions for a class or group of clients.

Importantly, members of superannuation funds are seeking advice as evidenced through a survey released at ASFA in November 2005, which rated what members want. The results² were as follows:

- high returns
- ease of contact
- administration
- advice from a financial adviser
- on-line transactions.

The value of advice and right to be remunerated for the establishment and ongoing servicing of this advice should also be recognised in superannuation legislation and APRA standards. This is disclosed clearly to clients in the SOA and whether it is charged directly to the client or taken from the fund with the client's permission is merely a collection method which offers the client flexibility to best manage their cash flows and capacity to pay. Clients should be allowed to pay for advice in a way that best suits them. The implication is that all public offer funds, should enable a client to elect to have the cost of advice debited to the fund if preferred.

Fees, whether paid as commissions or direct advice is just a method of paying for explicit advice. The method of payment should be a client choice. Consideration and legislative change is also needed to level out the tax treatment of advice costs to ensure one method of payment is not biased by the tax treatment over another.

Recommendation: The value of advice from a professional Financial Adviser can make a significant difference to the retirement savings for clients. This value should be more positively recognised in legislation to assist clients in maximising their superannuation benefits with further choice on how to pay for such advice.

The meaning of member investment choice

The extent of Australia's retirement savings gap is well researched. An IFSA report³ estimates the gap to be \$452 billion or \$93,000 per person. For many people the pressures of daily living and conflicting priorities make it difficult to increase the rate of contributions to a satisfactory level to comfortably close this gap.

Even without additional contributions, one strategy that can help close the gap is investment choice. An extra 1% investment return over 20 years on \$100,000 (taking the net earnings from 6% to 7% per annum) can amount to an extra \$66,255.

Default investment options play an important role where a client fails to exercise a choice, but to mandate any default strategies or to leave decisions to Trustees may restrict clients from achieving retirement goals. The value of advice as discussed above would be compromised and clients could be disadvantaged.

The Super Choice debate started over ten years ago, at a time when many compulsory superannuation funds had limited investment choice. However, the range of investment options available within superannuation has changed greatly,

² Source: Access - Mercer

³ Retirement Incomes and Long Term Savings Policy Options, IFSA Report, March 2006

particularly with the emerging prominence of master trusts which offer a wide variety of investment options. Most funds now offer clients the ability to choose options suited to their needs – and choice is generally facilitated by professional advice.

Education programs have focussed on member investment choice and referred clients to seek advice.

APRA should focus on regulations to ensure Trustees have adequate processes to manage the selection and inclusion of investment options on the menu and to prudently manage money invested. Trustees should provide sufficient choice on an investment menu to allow adequate diversification but should not focus at the level of individual member choice.

Also important for APRA to address is the extent to which Trustees should become involved in ownership and management of unrelated businesses as opposed to being purely portfolio investors. These activities could bring into question the capability and competency of superannuation funds to be owners of unrelated businesses and the reputational risk to superannuation more broadly arising if this risk materialises.

Recommendation: Regulation changes where necessary should be made to allow Trustees to recognise the financial advice received by a member as adequate for investment choice. Trustee activities should also be limited to relevant competencies, such as portfolio investment and management rather than control of unrelated businesses, to increase prudential management.

The responsibility of the Trustee in a member choice situation

With an estimated \$905.4 billion⁴ invested in superannuation rigorous prudential regulation is required.

The SIS Act requires Trustees to formulate an investment strategy for the fund taking into account issues such as risk and return and diversification. Under APRA's Superannuation Circular II.D.1, APRA expresses the view that the provision of a member choice strategy does not remove the need for the Trustee to ensure that the investment strategy or strategies of the fund comply with the requirements of the legislation. APRA interprets this under traditional interpretation of trust law to imply that individual advice from a Financial Adviser is not adequate for the Trustee to rely on as prudent.

APRA Superannuation Circular II.D.1 (March 2006) explains the requirements under SIS for managing investments and investment choice in APRA regulated superannuation entities. The view is taken that the Trustee of a superannuation entity is solely responsible and directly accountable for the prudential management of the entity's assets and development of an investment strategy at the entity level with regard to, among other things, risk and return, diversification, liquidity and liabilities. APRA's view appears to imply that member directed investment selection is not adequate (except for SMSFs).

⁴ *Quarterly Superannuation Performance* report, APRA, March 2006

Asteron is concerned about sections of this Circular, which infer that the Trustee may not be able to take the advice of a professional Financial Adviser to a member as adequate when reviewing the strategies for their members. While it is the role of the Trustee to determine the suitability of an investment at the fund level, it is neither appropriate nor necessary for a Trustee to supervise individual investments under "investment choice." This is also enforced by our comments in the sections above on the value of advice.

Also of concern is the fact that APRA's interpretation does not allow superannuation to be considered as part of a portfolio. The APRA Circular states that APRA does not favourably view situations where individuals have heavily invested in a single fund. While in isolation, this may appear to present concerns, as part of an overall portfolio and with specific advice, this may be an appropriate strategy.

Superannuation is a long term investment and is only part of a client's portfolio. The overall impact should be considered, not just one part of it.

Recommendation: Trustees should recognise the value of professional financial advice sought by members, and be allowed to accept this as meeting obligations for appropriate investment choice.

Cost of Compliance

Superannuation has been subject to a number of significant structural changes in recent years. Compliance is a major cost to all parties involved with superannuation including both Financial Advisers and superannuation fund providers.

In many cases, advice to small investors has become prohibitively expensive. Regulations under the FSR have imposed significant compliance burden, which has increased the cost of providing advice to levels that may not be affordable to many small investors. This means many people with the highest level of need are now excluded from advice.

Measures such as the recently announced simplification of super (Federal Budget 2006) will be welcomed to simplify super, but generally only create simplification for the retirement phase. Many changes (eg. limits on contributions) will in fact increase the complexity for clients in the wealth accumulation phase, further necessitating the need for advice.

Further legislative change is required to simplify the compliance for ongoing advice about superannuation (without disadvantaging the client) and for simple activities such as increasing insurance cover (due to events such as the birth of a child or loan increases) and switching investments options within the client's risk profile or strategy. Also needed is a simpler process for small amounts, as advice on the consolidation of these accounts (which is promoted heavily by government as a strategy) is too costly. Consolidation of small accounts could also be facilitated by the development of a standard industry form to be used and accepted by all participants.

Recommendation: Further simplification of advice regulations without disadvantaging the client is required to reduce the cost of providing advice to clients with small balances or simple needs.

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

The superannuation industry is now heavily regulated in relation to disclosure, particularly of fees. The costs in public offer superannuation funds are fully disclosed in Product Disclosure Statements which include the management fee. Costs of running the fund are included into this fee. But all funds need to operate on an even playing field for the calculation of fees and returns (reserving versus non-reserving is an example).

With many Industry superannuation funds, these costs are borne by the members of the fund from investment returns, so may not be as visible to members. This makes comparison of funds difficult and may create a biased view particularly with the ASIC view of advice requirements under super switching.

Recommendation: Industry practices should be considered in greater detail to ensure consistency in the calculation of fees and returns to members.

The meaning of the concepts “not for profit” and “all profits go to members”

The use of these terms infers that all profits generated from activities and services are allocated back to members or are delivered at a pure cost factor.

Within the Australian superannuation environment, these terms generally only apply to the Trustee itself and not to the services provided. Services such as investment management, insurance, administration and professional advice all often have a profit element. These services are usually undertaken by service providers which are fully or partly owned by the funds. These companies can operate for a profit, but a lack of transparency with reporting in the superannuation fund can make it difficult for clients and Financial Advisers to undertake meaningful comparisons with other superannuation funds.

Recommendation: The usage of the terms needs to be carefully considered and controlled to avoid potential misrepresentation. Funds using these terms should separately identify services which do not fit under these terms. This can only be achieved with Regulations for greater transparency.