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

INQUIRY INTO THE STRUCTURE OF THE SUPERANNUATION INDUSTRY

The Financial Planning Association of Australia (FPA) welcomes the invitation from the Parliamentary Joint Committee on Corporations and Financial Services to provide a submission to its Inquiry into the structure of the superannuation industry. The attached submission represents the views of its 12,000 members, many of whom advise clients on a daily basis on superannuation.

The key issue the FPA wants to highlight for the Committee is the importance for many ordinary Australians of receiving professional financial planning advice on superannuation. The decisions which need to be made and strategies which may be available go well beyond the specific selection of a superannuation fund suitable for an individual's particular circumstances, not a simple question in itself.

The FPA urges the Committee in considering the need for change to the superannuation regulatory regime to guard against recommendations which may compromise the ability of fund members to access affordable professional advice. Indeed, the FPA submission draws attention to a number of areas where the Committee may wish to recommend action which would facilitate the provision of advice.

The FPA would be pleased to go into more detail on the issues canvassed in its submission by providing evidence to a hearing of the Committee.

If you would like to discuss any of the issues raised in this letter please contact our Manager of Policy and Government Relations, John Anning, on 02 9220 4513 or john.anning@fpa.asn.au

Kind regards,

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**SUBMISSION
TO
THE PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND
FINANCIAL SERVICES**

**INQUIRY INTO THE STRUCTURE OF THE SUPERANNUATION
INDUSTRY**

1 SEPTEMBER 2006

Prepared by:
Financial Planning Association of Australia Limited

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SUMMARY OF KEY POINTS & RECOMMENDATIONS

The Role of Advice in Superannuation

- Advice is critical in achieving retirement savings goals.
- Advice encompasses much more than investment selection.

Recommendation: In considering the need for change to the superannuation regulatory regime, the Committee should guard against recommendations which may compromise the ability of fund members to access affordable professional advice.

The Meaning of Member Investment Choice

- An individual's superannuation arrangements should be considered in total and should not be apportioned between super guarantee and voluntary contributions for the purposes of advice or long term strategy.
- Member investment choice should be fully recognised within the SIS Act thereby allowing APRA to reissue Circular II.D.1.

Recommendation: There should be no mandated default investment strategy for SG contributions or any other super contributions. Regulatory change is needed to ensure a trustee can take into account individual financial planning advice provided to a member in respect of their superannuation.

The Responsibility of the Trustee in a Member Investment Choice Situation

- Current SIS laws fail to recognise member investment choice.
- The trustee role should concentrate on prudential issues.

Recommendation: Regulatory change is needed to ensure a trustee can take into account individual financial planning advice provided to a member in respect of their superannuation.

The Reasons for the Growth in Self Managed Super Funds

- Growth of SMSFs reflect the wish of people to exercise greater control over their superannuation.
- Strong need for professional investment advice.
- Current exemption enabling accountants to provide advice in this area should be withdrawn.

Recommendation: That the existing exemption under Corporations Regulations 2001-REG 7.1.29A be reviewed to ensure that only holders of an Australian Financial Services License are able to provide advice in respect to SMSFs

Cost of Compliance

- Extensive regulation over past decade has increased the cost of advice.
- FPA is working with Government and the regulator to ensure that the benefits of disclosure to consumers are not hampered by a disproportionate compliance cost.
- Period of regulatory stability needed to provide consumer confidence.

Recommendation: Simplification of compliance requirements relating to advice on superannuation to ensure more understandable documentation for clients and reduction of unnecessary costs for financial planners, including materiality provisions.

Whether Promotional Advertising should be a Cost to a Fund and therefore its Members

- The cost of promotional advertising borne by fund members may not meet “sole purpose” test.
- Full cost should be disclosed to members.
- Consistent standards of disclosure of alternative forms of remuneration should apply across all sectors of the financial services industry.

Recommendation: The full cost of advertising by funds should be disclosed to members where the cost is borne directly by the fund. Funds should also disclose any ancillary benefits received by trustees from sponsorships.

The Meaning of the Concepts “Not for Profit” and “All Profits go to Members”

- The structure of “not for profit” organisations should not preclude full disclosure of operational or investment costs.
- Standard performance reporting should apply across the industry to assist consumers and advisers.
- Lack of disclosure and standardisation of performance reporting make provision of switching advice difficult.

Recommendation: That the Committee address the issue of transparency of super funds particularly in the area of service providers and the issue of inconsistency of reporting fund returns.

Level of Compensation in the Event of Theft, Fraud or Employer Insolvency

- Current level of compensation under Super Safety Net provides incentive for trustees to manage risk
- Trustees now required to maintain adequate liability insurance
- GEERS should be extended to cover SG contributions.

Recommendation: That the existing level of compensation mandated under SIS should remain at 90% and GEERS extended to cover SG contributions.

Introduction

The Financial Planning Association of Australia Limited¹ (FPA) is the peak professional association for financial planners in Australia. It has taken a leading role in the protection of consumer interests by raising the standards of financial planning in Australia through the introduction of industry standards, educational programs and membership of a formal Complaints Scheme and is the sole licensee in Australia of the Certified Financial Planner (CFP) designation.

For the purposes of this submission, FPA has chosen to concentrate on the following matters from the Inquiry's Terms of Reference which it believes are relevant to the FPA and its constituency:

Terms of Reference

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.
7. The reasons for the growth in self managed superannuation funds.
8. Cost of Compliance.
11. Whether promotional advertising should be a cost to a fund and therefore it's members.
12. The meaning of the concepts "not for profit" and "all profits go to members".
14. Level of compensation in the event of theft, fraud and employer insolvency.

The Role of Advice in Superannuation

The need to maximise superannuation savings

It is recognised that superannuation is an integral part of our financial security and forms the basis of the retirement plans of all Australians. However, Australians expectations of their living standards in retirement are higher than the average person's current levels of superannuation will provide. This has been referred to as the "retirement savings gap"

¹ With approximately 12,000 members organised through a network of 31 Chapters across Australia and an office located in each capital city, the FPA represents qualified, professional financial planners who manage the financial affairs of over five million Australians with a collective investment value of more than \$560 billion.

and although it has seen a reduction in real terms over the past two years the gap is still significant at around \$93,523.²

A large number of Australians rely entirely on compulsory superannuation contributions to fund their retirement and hence will be disappointed when they reach retirement and discover the extent of their “retirement savings gap”.

How this can be facilitated with professional advice

The Government has taken significant steps to improve this position and encourage Australians to contribute more for their retirement, most lately in the very positive changes to superannuation announced in the recent Federal budget. However, FPA believes that appropriate and ongoing professional investment advice will also play a significant part in assisting Australians achieve their goal of a financially sustainable retirement.

The importance of advice in the accumulation and benefit phases of superannuation needs to be better promoted and encouraged by Government and regulators as inadequate financial advice and planning or indeed a lack of advice can result in dramatically reduced retirement benefits. This is particularly so given the complexities of many superannuation products and their regulation and few people today are able to make informed decisions without the benefit of proper professional advice.

Professional advice will continue to grow in importance along with the growth in superannuation holdings and it is unrealistic to expect that these significant sums of money can be well managed without professional advice. During the period 1997 to 2005 the average superannuation account balance grew by 66.2% to \$25,800 with small funds (SAFS and SMSFs) having an average balance of \$293,800.³

The role of a financial planner is to guide and assist their clients to meet their life goals through the proper management of their finances. The initial financial planning process involves identifying what is the client’s current financial position, any financial issues which need to be addressed and the client’s goals. As part of the financial planning process, the planner and client work together to reach those goals and address any challenges along the way.

The financial planning process relies on personalised and tailored advice from advisers licensed under the *Corporations Act* and administered by ASIC. The process is robust and contains numerous consumer protection mechanisms such as dispute resolution, competency requirements and professional indemnity insurance. Advisers are required to provide appropriate advice after making themselves familiar with their client’s circumstances, including any holdings outside of the superannuation environment or within other superannuation funds.

² IFSA Retirement Incomes & Long Term Savings Policy statement 2006

³ APRA 2005 Superannuation Bulletin

Superannuation choices are not simple

Advice is a much broader concept than pure investment advice and in terms of superannuation it can include advice on issues including: determination of superannuation retirement needs and income projections, analysis of risk profile, asset allocation, risk insurance, salary sacrifice strategies, tax planning, Government Co-Contributions and advice on possible Centrelink benefits.

Voluntary superannuation contributions on their own, even in so called “low fee, no commission” funds will not in the absence of professional financial planning advice necessarily achieve retirement goals and may even place those goals at risk by inappropriate asset selection and inadequate insurance protection.

An important element in advice is ensuring that adequate levels of risk insurance cover are maintained in order to protect the retirement benefit in the event of the death or disablement of the primary income earner. Membership of regulated superannuation funds in many cases enables the member to access such insurance at “group” rates which would not generally be available on an individual basis.

Whilst mandating a minimum level of life insurance cover from the “default” superannuation fund may go some way to addressing this problem, it also raises concerns. In particular, without sufficient education or advice members may believe that the mandated minimum levels represent sufficient cover. In reality this will often not be true.

In a speech to the Investment and Financial Services Association (IFSA) in 2005 then ASIC acting commissioner Berna Collier stated, “...*given the complexity of the tax and superannuation systems, current standards of financial literacy, and human frailties, there is considerable unmet need for quality advice*”.

The importance of “advice in superannuation” is further demonstrated by the results of a recent Newspoll survey conducted for the Investment & Financial Services Association (IFSA) which showed that those with a financial planner were more likely to have less debt, invest any windfall in superannuation, understand what factors contribute to their super fund earnings and make extra contributions to their super fund. Additionally, the survey also found that 67% of respondents agreed a qualified financial planner was the best person to help them with their financial affairs.

A 2002 report from the Association of British Insurers shows that 26%-46% (dependant upon income levels) of those surveyed would not have commenced saving without access to financial advice. Advice from a financial planner was seen as especially important for the self employed.⁴

⁴ IFSA Retirement Incomes & Long Term Savings Policy statement 2006

The value of advice demonstrated

A recent initiative of FPA has been the introduction in 2006 of industry “Value of Advice” Awards. These awards demonstrate the importance of financial planning not only in the wealth accumulation of individuals but the benefits for those with limited financial resources. The “real life” examples attached to this submission as Annexure “A” comprise a selection of winning entries from the inaugural awards and highlight the value that advice can provide and its importance in the financial well being of many individuals. The winning entry on post retirement planning on page 17 is particularly illustrative of the benefits which can be achieved from professional financial planning advice in the superannuation area.

By way of comparison it is interesting to look at several of the large industry funds, REST and HOSTPLUS⁵ where they disclose that 99% of members are invested in their default or balanced option, due to the apparent absence of individual advice. Whilst in the current market returns on these funds have been quite good it must be suggested that at least a percentage of those members would have been better off having received advice and placed in less conservative strategies such as Australian share funds or emerging market funds where returns have been up to 50% higher in the current economic environment. In these cases the benefits of receiving professional financial planning advice would most likely result in a greater retirement payout.

As life expectancy rates continue to increase and thus retirement income streams need to sustain people for much longer it is important that these retirement savings are maintained in wealth creation strategies for some time after actual retirement. This will be facilitated to some extent by proposed changes which do away with the need to maximise superannuation for lump sum withdrawals although the need to monitor and advise on these strategies will increase in importance.

There has been some criticism of fees and commissions being charged in relation to superannuation guarantee contributions paid into a member's account. The concern seems to be that the fees and commissions are somehow not earned or merited because they relate to money which is mandated by legislation to be paid into superannuation. However, if there is advice or some other service provided in relation to that money, it is legitimate for the provider of that service to be paid for that service. Any mandated move toward up front fee-for-service might disenfranchise lower income earners who simply cannot afford to pay for advice through an up front lump sum.

FPA initiative to improve transparency of the cost of advice and empower the client

On the issue of transparency, the FPA draws the Committee's attention to the Principles to Manage Conflicts of Interest which the FPA adopted in March this year. Principle One requires that FPA members explicitly agree a financial planning advice fee with their clients and the client to be able to vary or terminate the fee in line with their agreement with the planner. The financial planning advice fee is to be disclosed up front in the initial Statement of Advice and any ongoing advice fees are to be disclosed regularly,

⁵ www.hostplus.com ; www.rest.com.au

with the FPA recommending at least annually. Principle One reflects practices that are already being implemented in the financial planning sector. Compliance by FPA members will formally be expected from 1 July 2007.

FPA believes that this specific disclosure and agreement of the cost of financial planning advice is the crucial element in maximising transparency and so addressing conflicts around remuneration which the planner may receive from the product manufacturer. The method of payment is a secondary issue and could occur through an upfront payment, periodic debit or via the product.

Where the financial planning advice fee is paid via the product, FPA does not see this as commission because the amount has been agreed by the client and they can vary or terminate it. Any payments to the financial planner, even where they relate to advice, if they do not meet these requirements must be disclosed as commission. The FPA recommends as best practice that the amount of ongoing commissions be disclosed at least annually to the client.

Squarely faced with the cost of advice, consumers are better able to make decisions about the value of the service that they are receiving for the level of financial planning advice fee or commission being proposed. It is therefore probable that the nature of financial products offered will be different in future as planners and clients increasingly seek products where they have ongoing control over the payments for advice.

Recommendation:

In considering the need for change to the superannuation regulatory regime, the Committee should guard against recommendations which may compromise the ability of fund members to access affordable professional advice.

The Meaning of Member Investment Choice

The Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004 gave effect to the Government's policy to allow employees the right to choose which superannuation fund their compulsory superannuation contributions are paid into. To some extent, this choice of fund option provides members with a de facto investment choice as they are able to choose a fund which provides investment options which go further toward meeting their long term investment goals and needs.

FPA has been concerned at suggestions that mandated SG contributions should be carved out and paid into a standard default strategy. Such a proposal would effectively amount to a rescission of the concept of "Choice" which all political parties agreed to and would only achieve a fragmentation of a person's superannuation holdings, something that all stakeholders have been working to overcome. Default options in funds serve an important purpose where a member fails to exercise a choice but to mandate a default strategy for certain elements of retirement savings is counter productive to enabling people to achieve their retirement goals.

APRA Superannuation Circular II.D.1 which was released in March 2006 and replaced the earlier Circular released in April 1999 explains the requirements of the *Superannuation Industry (Supervision) Act 1993* (“SIS”) for managing investments and investment choice in APRA regulated superannuation entities. Under the SIS Act the trustee of a superannuation entity is solely responsible and directly accountable for the prudential management of the entity’s assets. This involves formulating an investment strategy at the entity level that has regard to, among other things, risk and return, diversification, liquidity and liabilities.

Whilst this did not prohibit trustees who so desire, to offer beneficiary investment choice, it only allows members a choice between investment strategies provided by the trustee, for example a choice between a balanced fund strategy and a capital stable fund strategy. It does not in the view of APRA extend to allow member directed investment except in the situation of small funds with less than five members. Even so, trustees of small funds must only accept the direction of members where the investment fits within the trustee’s investment strategy for the fund.

Many changes have taken place in the offering of member investment choice since the introduction of SIS in 1994 with many funds, particularly master trusts offering a wide variety of investment options. FPA is concerned that APRA’s interpretation of the Superannuation Industry Supervision Act 1993 (SIS Act) will undermine the member investment choice arrangements under which many public offer superannuation funds operate. This will have major implications for the superannuation arrangements of many clients of FPA members.

FPA is therefore concerned that parts of the Circular, particularly paragraphs 48 and 49, can be read as requiring trustees to ignore the advice given to a fund member by a professional financial planner. 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”. A strong argument can be made that any trustee unilaterally interfering with those selections would in fact be acting in contravention of their legal obligations.

FPA believes that APRA should focus on the need for:

- robust systems to manage all the options offered;
- a sufficient array of choices to enable the member to diversify risk;
- sufficient information for members about investment choices and their related risks; and
- appropriate systems to be in place to provide timely reports to members on their investment holdings and performance.

Limiting the degree of choice available within a fund and exercising control over the way a member allocates their funds would be contrary to the direction of Government policy as embodied in Superannuation Choice. This is significant as responsibility

for managing one's own superannuation is an important part of someone's coming to terms with the challenges of providing for a satisfactory level of retirement income.

When the draft Circular was put out for comment last year various sectors of the industry argued that a trustee should be able to have regard to the involvement of a professional financial planner if a member has made particular investment selections and choices. However it is understood that APRA has felt constrained by its interpretation of the current SIS law in this area.

In terms of member involvement in investment selection it is interesting to look at U.S. Department of Labor statistics for member investment activity in Section 401(k) plans.⁶ Of workers participating in savings plans, 91% may choose how their funds are invested and 65% may choose how the employers matching funds are invested. Of the 91% with investment choice 66% had actively engaged in selection of investment choices available to them.

Recommendation:

There should be no mandated default investment strategy for SG contributions or any other super contributions. Regulatory change is needed to ensure a trustee can take into account individual financial planning advice provided to a member in respect of their superannuation.

The Responsibility of the Trustee in a Member Choice Situation

The laws governing superannuation in Australia tend to have their origins in general trust law which presupposes that the trustee has the responsibility for all decisions made within the trust and superannuation fund members are passive beneficiaries. In the twelve years since the introduction of the SIS Act, the superannuation industry has developed into a sophisticated and complex industry with the capacity for members to take a much more active interest in their investments. This emphasis to provide members with a greater degree of control and say over their funds has not been fully reflected in the legislation which is still based upon the traditional trust law concept.

As pointed out in the previous reference heading, section 52 (2)(f) of the SIS Act requires the trustee of a superannuation fund 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 states 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.

It is understood that APRA feels constrained by its interpretation of the applicable law in this area to the extent that individual advice to a member from a financial planner need

⁶ www.bls.gov

not be taken into account by the trustee. This is notwithstanding that the advice from the financial planner may take into account the individual needs of the member, the extent of their other assets including other superannuation assets and general retirement objectives. In the view of the FPA, this has the capacity to limit the operation of the government policy as embodied in Superannuation Choice and discourage members from taking an active interest in their financial future.

If APRA continues to feel constrained in its interpretation of the relevant law in this area, the FPA calls for regulatory changes to confirm that professional financial planning advice taking into account an individual's needs overrides any general obligation a trustee may have in respect of Member Investment Choice.

Recommendation:

Regulatory change is needed to ensure a trustee can take into account individual financial planning advice provided to a member in respect of their superannuation.

The Reasons for the Growth in Self Managed Super Funds

Over the last decade there has been a growing interest in self-managed super funds (SMSFs). SMSFs are now responsible for around \$142 billion in retirement savings and, by 2013, this is expected to grow to around \$165 billion.⁷ There are currently around 300,000 SMSFs holding the superannuation assets of some 560,000 Australians.

This growth in SMSFs reflects the wish of many people to exercise a greater degree of control over their superannuation. Growth has been particularly strong in the area of high income earners who have a reasonably large amount of superannuation, typically in excess of \$200,000. For larger amounts, SMSFs can provide greater control and flexibility and may be more cost effective than institutional funds. Other advantages of SMSFs may also include:

- greater investment choice, particularly in direct shares and business real property
- greater control over members' tax position thus maximizing use of funds during financial year
- greater flexibility over estate planning and insurance options
- control over the timing of asset sales and selection.

Whilst anecdotal evidence suggests that the majority of these funds are well managed and pose little risk to members retirement needs, they could benefit from ongoing investment advice from financial planners.

Historically, accountants have been the first port of call for people looking to set up an SMSF. This is because they offer services from an auditing, compliance and tax perspective. However most accountants unless they hold an Australian Financial Services License are not legally qualified to offer investment advice and so the SMSF

⁷ Presentation to Taxpayers Australia by Ian Reid Deputy Commissioner of Taxation November 2004

trustee is frequently left to decide how to achieve maximum returns. A research project by the Australian Stock Exchange⁸ suggests that investment management was the most difficult aspect of managing an SMSF and many therefore tended to stay with investments they knew and understood thereby resulting in some lack of diversification. SMSFs can therefore benefit from the professional investment advice provided by financial planners both when initially considering whether to one should be established and from ongoing management.

The FPA believes that all market participants providing financial product advice on superannuation should be licensed and regulated by ASIC to ensure the protection of consumers. The current exemption provided to accountants under the Corporations Regulations at Reg 7.1.29A is confusing and does not extend to advising a client on the appropriateness of an SMSF. There is no valid reason for SMSFs to be treated differently and it is the view of the FPA that the existing exemption available to accountants is flawed and should be withdrawn.

FPA supports the concept of SMSFs as meeting the growing needs of people, particularly in higher wealth sectors to control their own superannuation. At the same time, the FPA believes it is important to encourage SMSF trustees to seek professional investment advice where it is required.

Recommendation:

That the existing exemption under Corporations Regulations 2001 – REG 7.1.29A be reviewed to ensure that only holders of an Australian Financial Services License are able to provide advice in respect to SMSFs.

Cost of Compliance

The last decade has seen a series of legislative changes imposed upon the superannuation industry and compliance with these regulations has become a significant operational cost to operators in the financial planning sector. A listing of the major regulatory changes over the past 10 years gives an indication of the extent of regulation:

- 1998 – Managed Investments Act
- 1999 – Super and Divorce
- 2000 – Financial Services Reform Act
- 2001 - Privacy Act
- 2003 – Super Safety (APRA Licensing)
- 2005 – Super Choice
- Expected late 2006 - Anti Money Laundering

Apart from the regulation of the superannuation industry itself, the provision of advice to superannuation fund members has become more expensive, in some cases prohibitively

⁸ ASX- Self Managed Superannuation Funds Research – November 2003

so according to FPA members, because of the prescriptive obligations introduced by the Financial Services Reform Act (FSRA). While supporting the general principles behind FSRA, the FPA has consistently argued to Government that the benefits to consumers from extensive disclosure were outweighed by the resulting compliance burden.

The cost of this regulatory burden and its impact on consumers has been recognised by the Government which has sought ways to address it through the recent Banks inquiry into Reducing Business Regulation and its willingness to consider adjustments to the financial services regulatory regime. It is also important to recognise that some period of regulatory stability going forward will be necessary in order to provide consumers with the confidence in the system which is so necessary when undertaking long term planning for retirement.

The FPA recognises that the "Simpler Super" proposals announced by the Government last Budget night will go a long way to addressing the superannuation issues identified in the Reducing Business Regulation report. Similarly the FPA has publicly welcomed the latest proposals for corporate and financial services reform released by the Parliamentary Secretary to the Treasurer, the Hon. Chris Pearce MP. The FPA would urge the Committee when considering its recommendations to keep in mind that, while consumer protection will always be a key objective of financial services regulation, any obligation must always pass a cost/benefit analysis.

FPA members are particularly concerned by the situation of low income earners with small amounts of superannuation who risk being disenfranchised from obtaining advice because of the complexities and costs associated with ASIC's Policy Statement 175. These are the people who are most likely to benefit from advice. It would be a failure of public policy if the cost measures meant to ensure the quality of financial advice actually prevented low income earners from benefiting from advice at all.

FPA is working on several fronts to make advice on consolidation of superannuation accounts more affordable while protecting the client's interests. In the regulatory refinement process mentioned above, the FPA has argued to the Government and Treasury for an explicit recognition of the ability to scale the advice to match what the client wants; for materiality thresholds before the obligation to provide a Statement of Advice (SoA) is triggered; and measures which would eliminate extraneous material from SoAs. FPA has had discussions specifically on these issues with ASIC to address the obstacles to consolidation advice found in its shadow shopping survey of superannuation advice. FPA will be also seeking to address with ASIC further issues concerning what constitutes a reasonable basis of advice. These arose most recently in the context of the enforceable undertaking agreed between ASIC and AMP Financial Planning.

Recommendation:

Simplification of Compliance requirements relating to advice on superannuation to ensure more understandable documentation for clients and reduction of unnecessary costs for financial planners.

Whether Promotional Advertising should be a Cost to a Fund and therefore its Members

In order that a fund qualifies as a regulated superannuation fund, it must comply with the sole purpose test which is required under section 62 of the SIS Act. This test requires that funds be maintained for the sole purpose of providing benefits to members on their retirement or on reaching the age for payment of preserved benefits, or to a member's dependants or estate on the death of the member before retirement. Payment of benefits may be made in addition to the above for certain ancillary benefits such as a member's ill health or premiums for life insurance cover.

The question therefore arises as to whether promotional advertising by a fund meets this sole purpose test.

Alternatively, under general trust law a trustee has a right to be indemnified against all costs and expenses properly incurred by it in the execution of the trust and include expenses which:

- arise out of the scope of acting as trustee
- are something that the trustee considers to be expenses reasonably incurred in administering and managing the fund.

The right for a trustee to take a "profit margin" is found in the relevant State Trustee Companies Acts and is only relevant where there is a for profit trustee company acting as trustee.

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.

In a letter to all trustees of APRA regulated superannuation funds dated 14 March 2005, the APRA Deputy Chairman Ross Jones stated in relation to the sole purpose test and fund advertising:

"...the test is broad enough to encompass normal activities of superannuation trustees [however] as a guiding principle, there should always be a reasonable direct and transparent connection between a particular scheme feature or trustee action, and the core or ancillary purposes...In our view, imposing marketing expenses on current members primarily to attract new 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".

Regardless of any legislative or general law restriction it is questionable whether extensive advertising by a fund for new members has any direct benefit for the existing fund members other than to increase or maintain membership and therefore possibly achieve some economies of scale in administration costs.

Retail funds on the other hand do not directly bear the costs of any fund promotion which is paid out of the trustees' or product manufacturers fees. In any event, where the costs of advertising by a fund are borne directly by the fund the full cost should be clearly disclosed to members in the fund's annual financial reporting. Where the advertising is for other than member educational purposes, some explanation should be included with the reporting as to the benefits sought.

Superannuation funds undertaking sporting sponsorships have received some media attention of late. Notwithstanding that executives of these funds have been quoted as suggesting they are simply marketing initiatives⁹, the required nexus between sponsorship and the funds core or ancillary purposes as referred to in the APRA letter of 14 March 2005 must be even more remote.

Again, on the issue of transparency, the question arises as to whether the "soft dollar" benefits which invariably flow from large sporting sponsorships such as access to corporate boxes at games are fully disclosed to fund members. The FPA and the Investment & Financial Services Association (IFSA) have jointly developed, with the support of ASIC, a Code of Practice on Alternative Forms of Remuneration which has been in place since 2004. In the view of the FPA, there is no reason why all sectors of the financial services industry should not be subject to similar disclosure requirements.

Recommendation:

The full cost of advertising by funds should be disclosed to members where the cost is borne directly by the fund. Funds should also disclose any ancillary benefits received by trustees from sponsorships.

The Meaning of the Concepts "Not for Profit" and "All Profits go to Members"

The general concept of a "Not for Profit" entity is one where the pursuit of profits or return on capital invested is not sought but where services are provided to certain defined persons. The meaning of "all profits go to members" on the other hand suggests an operation or undertaking where the pursuit of profit is a main objective along with the provision of services to members but where the distribution of those profits is allocated amongst the members. A prime example of these organisations would be mutuals such as credit unions.

Of the many claims made by Industry Funds, the key one is that they are "not for profit" or "all profits go to members" and the funds pay no commissions.

⁹ Financial Standard p.2,14/8/2006

It is assumed therefore that Industry Funds are suggesting that they are funds which seek to allocate “all profits to members” rather than funds that do not make a “profit”.

However, meaningful comparison with retail or “for profit” funds becomes extremely difficult. Most Industry Funds have a trustee which is a \$2 company and all management of the fund including investment management is undertaken by service providers, some which are owned or partially owned by the funds.

As a result detailed operational and investment costs are not disclosed at fund level making comparisons with other retail or corporate funds extremely difficult. Another issue which highlights ability to compare is the difficulty a financial planner faces when attempting to advise a client where a “From” fund is an Industry Fund. Current ASIC guidelines on this issue suggest that if information cannot be obtained from the “From” fund the planner can’t provide switching advice with the consequence that a client wishing to switch out of an Industry Fund must do it on their own without any advice. A number of members have indicated difficulty in securing information from industry funds to make the comparison.

Industry Funds also report performance differently to the rest of the industry which generally operates under IFSA Standard No 6 which requires performance to be reported after all fees. Most superannuation master trusts (corporate and personal) report performance after deducting administration fees of 1% to 1.5%. Industry funds on the other hand typically do not deduct administration fees (mostly referred to as a member fee) from reported performance.

Recently, Industry Fund Services (IFS) has promoted a new performance measurement – the “net benefit to members” concept. This calculates returns before fees and after tax and divides these by after tax fees to show the earnings provided for each dollar taken out in fees. Whilst this recognises the end benefit to members it clouds the contribution which performance and fees make individually to the end return for the member.¹⁰

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. It is also questionable as to whether the trustee would be in a position to take legal action against these service providers in the event they were in breach of their contractual obligations to the fund when that fund was a partial owner of the service provider.

Again it is difficult for advisers to provide advice on industry funds when some of their assets such as their investments in the ownership of service providers do not report a return on capital as part of the funds financial reporting. This has become even more important now that Members Equity Bank has been acquired by a number of Industry Super Funds.

¹⁰ Chant West Public News Report July 2006

Members Equity Bank is a significant financial institution with over \$10 billion in assets, the majority of which are securitised home loans and it presumably provides a dividend or some other form of return to its Super Fund owners. This ownership structure also raises questions about any potential liability which the fund may have in event of the failure of one of these businesses.

Recommendation:

That the Committee address the issue of transparency of super funds particularly in the area of service providers and the issue of inconsistency of reporting fund returns.

Level of Compensation in the Event of Theft, Fraud or Employer Insolvency

The Super Safety Net was expanded in 2004 providing broad discretion to the Minister to compensate members whose superannuation fund suffers losses as a result of theft, fraud or employer insolvency. The level of compensation under SIS is currently capped at 90% of the losses incurred.

APRA's Information paper on Trustee Liability Insurance issued in June 2006 requires trustees to maintain adequate levels of insurance against liabilities as a result of breaches of professional duty. Insurance brokers consulted by APRA during the course of the development of this Information paper suggested that trustees should have a minimum level of cover between \$1 million and \$5 million irrespective of the level of funds under trusteeship.

Whilst it is recognised that superannuation is an important element in the Government's Retirement Incomes Policy, if it were to be protected at 100% of a members assets such an increase in compensation benefits would provide little or no incentive to trustees to manage risk. The existing level of statutory compensation coupled with the requirement for trustees to maintain adequate insurance cover provides a strong safety net whilst retaining an incentive for the continued management of risk.

As Trustee Liability Insurance and the Super Safety Net do not provide any compensation where there is employer insolvency and Superannuation Contributions (SG) are outstanding, it is our view that the General Employee Entitlements & Redundancy Scheme (GEERS) should be extended to cover any unpaid SG contributions.

Recommendation:

That the existing level of compensation mandated under SIS should remain at 90% but GEERS extended to cover Superannuation Guarantee Contributions.

ANNEXURE



FINANCIAL PLANNING ASSOCIATION VALUE OF ADVICE AWARDS 2006 SUMMARY CASE STUDIES

NATIONAL WINNERS

CATEGORY: Wealth accumulation

NATIONAL WINNER: Philippa Elliott CFP®, Epic Adviser Solutions, WA

Dave (34) and Helena (36) have two young children (aged 3 and 4). They rent in order to live near a good school, but own an investment property and hold an investment portfolio. Their short-term goals are to be financially stable, purchase an additional investment property, take a holiday to New Zealand and increase their investment portfolio. Within the next 10 years they will need to fund the children's education, buy a second car and want to further grow their investment portfolio. Beyond that, their sights are set on buying their own home and an investment property for the children, sending the children to private schools and upgrading the family car.

Philippa advised them to consider a superannuation salary-sacrifice strategy for its tax benefits; take advantage of the Government's co-contribution scheme for Helena; commence a geared investment strategy to create long term capital growth and tax savings; and manage cashflow more effectively with a budget.

Dave and Helena's financial plan has delivered benefits over and above their expectations, including a family holiday every year, a new car in the next 18 months, and school fees for both children. They have also protected their future in the event of illness, injury or death. Their net assets without advice (and without achieving any of their lifestyle goals) would have been \$454,500 in 2006 and \$1.387 million in 2015. With the benefit of advice (and achieving their lifestyle goals) assets were \$535,000 in 2006 and are projected to grow to \$1.471 million by 2015.

CATEGORY: Pre-retirement planning

NATIONAL WINNER: Rod Scurrah CFP®, Garvan Financial Planning, TAS

Barry (55) and Janette (50) want to retire (Barry in two years, Janette in four) and decided to get professional advice to help them plan for a comfortable retirement and to resolve some concerns. They needed \$10,000 to pay for a holiday in the next few months and wanted both a retirement income of \$120,000 per annum, indexed to inflation, and accessible funds for other ad hoc expenses.

Rod recommended that both Barry and Janette start making additional superannuation contributions to build their funds and take advantage of the lower tax. He advised them to invest surplus income into a managed fund with dollar cost averaging which would help to manage volatility and maximise returns.

Barry undertook a buy-back of his past service to avoid early retirement penalties and increased his pension by almost \$10,000 per annum in addition to tax benefits. He proposed that Janette postpone retirement until she turns 55 in order to retain her defined benefit fund and full benefits.

Rod's advice enabled Barry and Janette to minimise income tax and direct more money into super and a managed fund. The latter generated higher returns and funds were easily accessible if required. Barry's pension was maximised and the tax component reduced. Combined, Janette's super and Barry's pension gave them the retirement income they needed – and they had peace of mind that a comfortable retirement was achievable.

CATEGORY: Post-retirement planning and management
NATIONAL WINNER: Ben Hatcher CFP®, Hillross Financial Services, NSW

Jennifer (57) is divorced and suffers from severe osteoarthritis which means she is unable to work. She owns her home but has no regular income and for the past few years has been living off lump sums drawn from her existing investments. She has been extremely reluctant to see a financial planner, but was convinced to make an appointment by her accountant who was getting concerned about her financial situation.

Jennifer acknowledged that she could benefit from advice that gave access to a lump sum to help her daughter with her wedding and also to undertake urgent repairs to her home. In addition, Ben was able to advise on Centrelink benefits, consolidation of superannuation and a strategy to achieve an annual income of \$19,000 a year, whilst ensuring Jennifer's capital will last her lifetime.

A major part of Ben's role was to help Jennifer understand all the options available to her, support her in her choices, and ensure that her finances were set up in a way that she could easily understand and manage. He consolidated some of her superannuation and investments, at the same time identifying a substantial lump sum payment arising from income protection insurance contained within other policies. Jennifer was unaware of this insurance and has now received in excess of \$18,000 in back pay and is receiving a regular monthly amount of \$750 for the next 2 years.

During the process, an additional \$30,000 was uncovered in one of the super funds which Jennifer did not realise she possessed. Ben also identified a Centrelink disability support pension of \$12,500 a year – a significant part of Jennifer's desired income. In addition, he restructured investments to give some exposure to growth assets.

Without this advice, Jennifer would soon have exhausted her capital and be totally reliant on the aged pension. As a result of the new strategy, Jennifer can enjoy a higher income level immediately and it is estimated that even when Jennifer is in her early 80s, she will still have around \$140,000 available. Ben gave Jennifer confidence that her finances would provide for her future, and made them much easier to understand and manage.

CATEGORY: Low income planning
NATIONAL WINNER: Neil Kendall CFP®, Charter Financial Planning, QLD

Kathy (33) lives with her mother Maria (66), her brother Philip (43) and her son Alex (9). Philip has schizophrenia and is unable to work, and Maria is his main carer, as well as working as a part-time cleaner. The family finds it very difficult to make ends meet. Kathy first met with Neil to discuss rolling over and consolidating her superannuation.

Neil was able to help the family in a number of areas, including advising Kathy to roll her four separate superannuation funds into one and selecting a multi-manager fund which provided diversification; arranging life insurance to protect Alex; identifying an entitlement to a total and permanent disability payment from Philip's superannuation fund; and determining eligibility for Centrelink benefits. In addition, he registered Maria with the pension bonus scheme to receive an entitlement when she retired and assisted with paperwork from her super fund, which was questioning her eligibility to remain in the fund.

Kathy's original goal for her superannuation was easily achieved, and other areas uncovered where financial advice was valuable included a \$40,000 payout from Philip's superannuation fund, which the family were not aware he was entitled to, and regular Centrelink benefits; helping Maria understand her entitlements and allaying her concerns about letters and forms from her superannuation fund. He also provided peace of mind for Kathy by arranging life insurance through her superannuation in favour of Alex, which she would not otherwise have been able to afford.



**FINANCIAL PLANNING ASSOCIATION
VALUE OF ADVICE AWARDS 2006
SUMMARY CASE STUDIES**

STATE WINNERS

CATEGORY: Wealth accumulation
VIC STATE WINNER: Anne Graham CFP®, Securitor Financial Group

Jeremy (41) would like to take advantage of a strong financial situation to make sure he has a secure and comfortable future. He is on a very good income of \$115,000 and shares home ownership with a friend. However, his friend is thinking of selling his share of the property, and Jeremy isn't sure whether he can afford to buy that half, or whether he should sell and purchase somewhere else on his own. He would like to get started in preparing for his retirement, and ensure his current insurance is adequate.

Anne's main areas of advice were to set up a savings plan to ensure his surplus income is better used; set up a salary-sacrifice arrangement to add discipline to savings, take advantage of lower tax rates, and increase the funds in his super; and to take out income protection. In addition, she developed scenarios that allow Jeremy to understand the impact of accelerated payments on a mortgage – which produced savings in excess of \$230,000 over the term of the mortgage.

A dedicated savings plan will allow Jeremy to save enough money in 18 months to purchase his own home. It is anticipated that Jeremy will have an extra \$375,000 in retirement thanks to the salary-sacrifice arrangement, as well as being much closer to his retirement income goal of \$50,000 a year.

CATEGORY: Pre-retirement planning
VIC STATE WINNER: Anne Graham CFP®, Securitor Financial Group

Megan (52) is single and cares for her elderly mother. Megan has an investment portfolio but wanted to review it to ensure she can achieve her goals: a comfortable retirement with an income of \$15,000 a year; to buy her own home; and to be able to access a lump sum of \$40,000 in case of emergencies. She was looking for a straightforward strategy which allows her to take advantage of new investment opportunities, changes in tax or superannuation legislation, and any changes in her personal situation. Megan's salary is \$55,000 a year plus income from her investments of around \$20,000. Her expenses are relatively small.

Anne recommended salary-sacrificing; researching and identifying a suitable high-interest savings account; and reviewing existing superannuation funds. She also assessed Megan's levels and range of insurance, and reviewed her existing shares and managed funds.

The salary-sacrifice arrangement makes good use of Megan's surplus income. As well as increasing her superannuation investments, it also reduces her marginal tax rate from 42% to 30% while still retaining a cash flow surplus of over \$8,500. Rolling over her superannuation funds into a new WRAP account, reduced the fees paid through multiple funds and ensured strong returns. Non-super assets were moved into super to provide for retirement needs, reduce income tax and overall fees. Anne was also able to save Megan unnecessary insurance premiums by uncovering her ability to 'self-insure'.

CATEGORY: Post-retirement planning
VIC STATE WINNER: Anne Graham CFP®, Securitor Financial Group

Ross and Lorraine retired a few years ago at 60, but they weren't eligible for Centrelink pensions and their income came from allocated pensions already set up by Anne. Their existing levels of superannuation also meant they didn't meet the asset test for other Centrelink benefits. Ross is now almost 65 and several regulatory changes may influence their eligibility for Centrelink, so they have decided to review their financial situation. Ross and Lorraine's existing income from the allocated pension and other investments was falling significantly short of their desired \$33,000 annual income.

Anne's recommendations included cashing out \$135,000 from Ross's super and reinvesting it as an undeducted contribution (thus minimising any tax) into a managed fund in Lorraine's name; rolling over \$280,000 from Ross's super into a Term Allocated Pension (minimising any capital gains tax and taking advantage of the favourable asset test treatment to access the Centrelink Age Pension); and retaining Ross's existing allocated pension due to its favourable tax treatment.

Together, the new investment strategies and the Centrelink benefits have produced the desired annual income, while still allowing Ross and Lorraine to access to their capital if required. They also have the investment in Lorraine's managed fund, with distributions reinvested to continue building up wealth over time while still being accessible if required.

CATEGORY: Post-retirement planning
QLD STATE WINNER: Neil Kendall CFP®, Charter Financial Planning
Brian (64) and Jill (63) are selling their newsagency business and retiring. They own their home as well as an investment property, a beachside holiday unit that has been in the family for many years and which they would like to keep in the family. Brian's retirement has been forced by ill health so they haven't planned ahead and need help.

Neil developed a number of scenarios to show the financial impact of keeping the investment property, and to enable them to make their own decisions. He looked at entitlement to Centrelink benefits; Brian's existing life insurance; and a range of managed investments suitable to their situation and risk profile.

Keeping the investment property would impact their potential income for the next 20 years. Selling it meant they had more funds to invest and would be entitled to higher Centrelink benefits due to the asset test, almost doubling their potential income from around \$26,500 to \$43,500. They decided to sell to their daughters, allowing Brian and Jill to achieve a comfortable retirement but keeping the property in the family. Neil advised on a continuation option on Brian's life insurance, maintaining important protection given his ill health, and on moving some funds to a Term Allocated Pension to maximise their benefits and gifting within the Centrelink rules.

CATEGORY: Wealth accumulation

NSW STATE WINNER: Harry Moustakas CFP®, AMP Financial Planning

Teresa (40) lives with her elderly parents and is their main carer. She works full-time and earns \$45,000 per annum. Harry has been her adviser for almost 10 years, helping her maximise savings and build wealth through investments and property. He started out by encouraging Teresa to keep a budget to track spending patterns, set a disciplined approach, and free up surplus income for investment.

By 2000, Teresa had saved enough money to put down a deposit on an investment property with an excellent rental return. Harry advised on income protection insurance so that her investments would be secure even if Teresa had no regular income for a period. Later, he proposed a gearing strategy, explaining the risk associated with debt and the opportunity to build wealth. When made redundant two years ago, Teresa had the money to tide her over, and was able to maintain her investment strategy until she found a new job. Teresa is confident in her financial security and can afford holidays and other lifestyle goals.

The Value of Advice Awards case studies are real life examples of the provision of financial advice to clients by FPA members who are CFP® practitioners - the highest international designation in the financial planning profession - or enrolled in the CFP Certification Program. The case studies demonstrate the value of financial planning advice. Only the names of the individuals mentioned in the case studies have been changed to protect their privacy. The advice provided in the case studies has been tailored to the individual needs of the clients. You should not rely on the advice given in the case studies for your own personal situation. If you wish to see how financial advice can benefit you, consult an FPA member who can provide tailored financial advice to meet your individual needs.