



**The Institute of
Chartered Accountants
in Australia**

30 August 2006

Mr David Sullivan
Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Parliament House
Canberra Act 2600
Email: corporations.joint@aph.gov.au

Dear Mr Sullivan,

Please find a submission from The Institute of Chartered Accountants in Australia (The Institute) to the Committee's current Inquiry into the superannuation sector. The Institute is one of Australia's peak professional bodies and our members represent many of Australia's peak business and finance professionals. These members act as advisers and key-decision makers in all facets of the superannuation industry.

The submission below represents the view of The Institute and has been prepared based on input from a variety of members in their capacity as trustees, service providers and fund members of funds of all sizes.

The Institute is committed to working with the Parliament to examine and clarify important public policy issues such as the issues canvassed by the Inquiry's Terms of Reference. We would welcome the opportunity to appear before the Committee in due course to answer any questions from Committee members and expand on the points made in our submission.

Should you have any queries please do not hesitate to contact Dr Barbara Carney, Manager Government Relations, on 6282 0591 or carney@icaa.org.au.

Yours sincerely

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INSTITUTE OF CHARTERED ACCOUNTANTS IN AUSTRALIA

SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES INQUIRY INTO THE STRUCTURE AND OPERATION OF THE SUPERANNUATION INDUSTRY

1. Whether uniform capital requirements should apply to trustees

APRA regulated superannuation funds are subject to prudential regulation which increasingly requires funds to maintain capital reserve for the management of operational risk. This model provides for the need for constitutional corporate trustees to hold capital as reserves for unusual events while ensuring that the superannuation funds' assets are available to provide returns on the investment for fund members.

The Institute does not see a need to change this model. However, we **recommend** that APRA develop guidelines clarifying the method of determining the quantum of the reserve and the operational rules governing the operation of the reserve. This will ensure reserves are used consistently across the industry.

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

All APRA regulated superannuation funds are required to prepare general purpose financial statements in accordance with AAS25 'Accounting for Superannuation Plans'. The Institute notes that the Australian Accounting Standards Board has undertaken to review this standard to ensure that the financial statements prepared continue to be relevant to users.

The trustees of ASIC licensed entities are required to prepare and lodge financial statements in accordance with the Corporations Act. While this does not encompass all superannuation fund trustees it encompasses many entities.

APRA through its regulatory activities monitor the trustee companies and will require the preparation of financial statements for trustees which hold assets and meet operational costs from assets held separately from the funds investment activities.

Many SMSF trustee companies are shell companies put in place to ensure the efficient management of the superannuation fund as there is less administration when adding and removing trustee board members. There is no value in requiring these entities to prepare general purpose financial statements, as there is no separation between the users of the information and the fund members.

It is therefore **recommended** that the existing arrangements continue.

3. The relevance of Australian Prudential Regulation Authority standards

APRA standards are well regarded by industry and are used by trustees of all fund types to the extent that they address general superannuation issues. The Institute **recommends** that resources be allocated to the revision of standards in the 2007-2008 financial year. Revisions are required to ensure standards reflect the recent changes in the regulatory model and the proposed changes to the legislative environment.

4. The role of advice in superannuation

The introduction of superannuation choice in July 2005 brought to the forefront the critical importance of receiving advice in regards to superannuation and retirement planning solutions. Based on the Government's wide range of changes in the May 2006 Budget and the introduction of concepts such as Transition to Retirement this has increased the importance of ensuring individuals receive the most appropriate advice for their retirement savings. This need has further been emphasised and in some ways complicated by the increase in the amount of media coverage and advertising in this sector of the industry.

While the recent Budget changes have reduced the complexity of taxation on the end benefits for individuals over 60, the fact that Australians are living longer emphasises the need for advice in regards to superannuation and retirement planning is imperative.

The importance of this advice is reflected by the Government's endeavour for consumers to take more responsibility and the roll out of the Financial Literacy Foundation program. This indicates that the consumers have a limited knowledge of their retirement and financial needs, as a result require assistance in terms of advice.

There is a wide range of challenges in the delivery of appropriate and cost effective advice to consumers. As has been shown in data from an Institute survey there is a degree of apathy when it comes to consumers' attitude to consolidation, which also may well be interpreted as consumers' view generally on superannuation.

The FSR regime has resulted in an increase in the compliance and regulatory burden on providers of advice and the manufacturers of superannuation products. Many of the key elements of FSR have led to risk management documentation as opposed to consumer friendly documents to assist consumers in their decision making process.

- The increase in the compliance requirements has resulted in a reduction in the opportunity for consumers to receive simple personal financial advice. For example the extensive requirements of a Statement of Advice for the most simple advice has led to it being, in many cases, not commercially viable for advisers to provide advice. Further the FSR regime has removed the opportunity for accountants, who are well placed to provide assistance to clients on a wide range of financial advisory issues, to provide a

comprehensive service to consumers that would be most valuable in their decision making process.

- For the product manufacturers the FSR requirements have led to Product Disclosure Statements that, while providing and disclosing the mandated information for the consumer, creates complexity and detail that are beyond most consumers' understanding. PDSs have become risk management tools – as a result consumers are unable to effectively and easily understand the product offering. While there are areas of assistance such as the ASIC Fido website to assist consumers, the FSR regime is still very complex.

While the FSR framework has provided a range of benefits and has a positive intent to improve the advice provided to consumers it can be argued that a “one size fits all” approach is not practical.

One of the key challenges of providing financial advice in the current environment is the ongoing debate of how to manage conflicts of interest, whether real or perceived. There is more required than just transparent written disclosure delivered to the consumer. The Institute supports further investigation of the opportunities in regards to the tax deductibility of financial advice fees. This is a complex system; however an opportunity to reduce the complexity will assist in reducing the costs for consumers and assist in reducing the concerns relating to conflicts of interest. This would provide an enormous benefit to the superannuation industry.

The Institute will continue to work closely with the Government and the Parliament to clarify and develop solutions to ensure the public interest is appropriately served in providing advice on superannuation.

Australians' superannuation and retirement savings are of critical importance to the Australian economy and to individuals' future lifestyles. The need for advice in regard to this key area cannot be under estimated.

5. The meaning of member investment choice

Investment choice means the right to choose investments within the superannuation fund to meet a person's objectives.

The choices made available to fund members will vary from a limited selection reflecting low, moderate and high risk exposure to an à la carte menu encompassing the full investment horizon. Under choice of fund the member will select the fund which offers the investment choices they feel most at ease with. They will then select investment options accordingly.

One aspect of the introduction of investment choice is that it focuses the member's mind on short term performance. While short term performance is important, it is necessary that consumers have access to education about the interaction of risk and return and the need to focus on the longer term when dealing with some asset classes.

Fund members with savings in a variety of products may need to obtain advice on the appropriate asset allocation to ensure that they maximize their savings. For example, this can be achieved by investing in growth assets within superannuation. Assets which show low growth but receive favorable tax treatment in the form of imputation credits, might be held by members outside the fund.

With the improvement of Australians financial literacy the current member investment choice model operates effectively.

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

The SIS legislation makes the trustee responsible for managing the investments of the fund in the best interest of members. As noted above some trustees achieve this though limiting investment options while others allow the member to direct their investments explicitly, with some restrictions, such as not allowing the member to put all their eggs in one basket. The legislation has not however kept up with this change as it fails to alleviate the trustees' responsibility for decision making where a full menu of investment options is offered.

Member investment choice should not be mandatory when investors can chose the fund which offers the selection of investment options they desire.

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

There are many reasons for the growth in superannuation funds. The main reasons focus on their flexibility and the fund members' desire for control. Some in the market view SMSFs as a lower cost option. However costs are driven by the size of the funds, the underlying fund assets and the 'members' willingness and ability to truly do it themselves.

Flexibility

Some accountants have encouraged their clients to use self managed superannuation funds as a means to diversify investments into direct property, direct shares and specialised projects. On the whole superannuation funds allow a wide range of investments and some investments can be acquired more easily, for example direct property, through them.

Control

Where more members have control over their funds and the ability to diversify their assets within the superannuation fund, trustees can more readily recognise whether the superannuation fund is performing and can assess the reasons for this more easily.

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

Early superannuation arrangements were via defined benefit funds wherewith benefits were weighted towards those members who spent long periods with the one employer. This provided a benefit to encourage employees to stay with the employer for long periods.

The employment environment which sees more changes in employment and shorter periods of employment is better supported by accumulation schemes. The employees are able to better select the fund which will meet their needs.

Recent changes to the accounting standards have required that the movements in defined benefit assets and liabilities be reflected in the financial statements of the employer. This accounting standards' change has discouraged employers from operating these schemes, particularly in periods of poor investment returns.

9. Cost of compliance

APRA regulated superannuation funds have seen a significant increase in the regulatory environment via changes to both APRA and ASIC regulations.

A particular issue which was highlighted into the regulation review, was the duplication of audit reporting and the mismatch in reporting obligations between regulators. The review findings have recommended that ASIC and APRA work together to resolve these issues. We support the government finding and look forward to working with government and regulators to resolve this issue.

Financial planning

FSR has seen the regulation of advice take a "black letter law" approach which results in advisors adopting a checklist mentality to ensuring that everything is covered, rather than to adopt a more preferable consumer-focused approach.

This has resulted in an increase in the costs of providing advice, making advice less accessible for many Australians. Not obtaining appropriate advice may lead to shortfalls in savings at retirement and a failure to be appropriately insured.

10. The appropriateness of the funding arrangements for prudential regulation

Regulation is funded by the entities being regulated. Therefore it is appropriate that checks and balances be put in place to ensure that regulators operate efficiently. In particular, the changes in the structure of the market place with fewer funds to regulate, should be reflected in the reduced expenses of the regulator and lower funding requirements.

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

We do not believe that it would be appropriate to prohibit superannuation funds from advertising. However in our view it is imperative that the costs are disclosed to ensure that members are aware of the impacts of such costs on members' returns.

Advertising costs are expense items and therefore should be reflected within the management expense ratio calculation. A superannuation fund should NOT be allowed to distort its true management expense ratio by masking costs and reporting lower performance figures, through offsetting advertising expenses against investment returns.

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

These terms are misnomers as all superannuation funds pay for administration, investment and other services. The difference between funds is whether the entity being paid for providing these services is related or unrelated.

A superannuation fund which is a product offered by a listed entity frequently engages related companies as its service providers. The profits of the listed entity would include those of all of its trustees together with its related service providers. By contrast, where an industry or corporate fund engages service providers, these are more likely to be unrelated. However these arms-length service providers fees would also include a percentage of profit for the owners of the service provider. Thus the fees of all superannuation fund trustees would include elements of 'profit', regardless of whether they are classified as retail, corporate or industry funds.

13. Benchmarking Australia against international practice and experience.

We agree that this could be a useful tool. The comparison of returns and costs of operation between funds locally and internationally will highlight inefficiencies which may exist in the legislative or regulatory environments.

Work of this nature is currently being undertaken by CEM in Canada.

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

We are comfortable with the current regime

15. Any other important matters

Accounting and the Industry

The SIS Act and Regulations are very complicated and result in high administration and audit costs. There is scope for further simplification and improvements in efficiency. These however need to be carefully planned and implemented with bipartisan support as constant changes to legislation increase the inefficiency in the industry.

Co-contribution system

The Co-contribution system should be extended to non-working spouses, as it seems illogical imposing a minimum 10% income from the employment, as a test. The budget announced that the co-contribution system would be extended to self employed people. If it was extended to non-working spouses, many of whom would be raising children, the change would result in substantial an increase in their superannuation fund savings.

This extended facility could be made subject to a household means test, and paid to non-working spouses who do not have substantial income, and where the spouse has an income under a particular threshold.

Areas to address when looking at improvements in financial literacy

The financial literacy of many Australians is limited. They do not have the appropriate financial education and knowledge to insure appropriately to protect their families. Frequently they are underinsured, this can lead to inadequate compensation upon the injury or death of the insured.