The Secretary
Parliamentary Joint Committee on Corporations
and Financial Services
Suite SG.64
Parliament House
Canberra ACT 2600

4 September 2006

Dear Mr Sullivan

**Inquiry into the structure and operation of the superannuation industry**

I refer to your correspondence of 7 July 2006 inviting AXA Australia to make a submission in respect of the Parliamentary Joint Committee on Corporations and Financial Services' (the Committee) inquiry into the structure and operation of the superannuation industry.

AXA Asia Pacific Holdings Limited (AXA) is a leading provider of superannuation, life insurance, managed investments, investor directed portfolio services and financial advice, to retail clients in the Australian financial services market.

AXA welcomes the review being undertaken by the Committee. Superannuation has been the subject of numerous changes over the past 20 years, including the introduction of compulsory (and almost universal) superannuation contributions, superannuation surcharge, government co-contributions, splitting of superannuation accounts upon divorce, investment choice, spouse contribution splitting, and binding death benefit nominations. The recently announced Federal Government 'Plan to Simplify and Streamline Superannuation' continues this trend. This is, therefore, an opportune time to take a broader look at the superannuation regime in Australia.

If you have any queries in relation to the attached submission or would like to discuss any part further, please contact Greg Mullins, Compliance Manager for Superannuation and Insurance, on 03 9616 3083.

Yours sincerely,

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00035-01/025

# Submission to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the Structure and Operation of the Superannuation Industry

September 2006

## Introduction

AXA Asia Pacific Holdings Limited (AXA) is a leading provider of superannuation, life insurance, managed investments, investor directed portfolio services and financial advice, to retail clients in the Australian financial services market. As such, AXA has a keen interest in the Committee's current inquiry.

Superannuation operates within a trust structure, with its basis in equity law. Thirty years ago, superannuation funds operated much like any other trust - the Trust Deed gave the trustee wide powers and discretions and the beneficiary had very little say in the way the fund operated or the type of benefits paid . Defined benefit funds predominated, and in these structures the sponsoring employer bore the cost and the investment risk. In most cases the member was automatically enrolled in a superannuation fund by his employer. Life companies also offered superannuation products in the form of traditional insurance products which had been modified slightly to take advantage of the tax benefits associated with superannuation.

Today, superannuation is very different. The traditional trustee/beneficiary relationship has changed significantly with the balance of responsibility for key decisions shifting towards the member. There is now a market for superannuation products and individuals are expected to choose for themselves from a bewildering array of products and structures. Exercising the informed choice required for this market to function effectively requires an unprecedented level of knowledge and expertise. In order to be able to exercise such choice, members require information about the available superannuation products. To facilitate this information requirement trustees are obliged to produce a Product Disclosure Statement. Product Disclosure Statements are long and detailed documents. While the need for informed choice is self evident, the ability of many individuals to assess the information available in the market is limited.

Today, the superannuation funds that are available for members to choose from are almost exclusively accumulation style funds. As benefit structures have moved from defined benefits to accumulation style benefits, the investment risk associated with the benefit has shifted to the member. In order to effectively manage this risk the member needs to be provided with ongoing information about the asset allocation and investment performance of the fund, and the impact of fees on his investment.

While mandatory contributions provide a base for retirement, Australians are told (correctly) that this will not be enough, and that they must make additional contributions to secure their retirement life style. To be able to act on this information, members require a good understanding of both their current financial situation and the retirement income that they will need in order to fund the retirement life style they desire.

Superannuation fund members no longer meet the traditional, passive profile of beneficiaries that is enshrined in the law of equity. Over time, superannuation fund members have been provided with the opportunity to take greater control of their retirement savings. In this environment, access to quality financial advice is increasingly important.

As is to be expected the Australian population's response to changes in superannuation has varied widely, from apathy and inertia to demands for an even greater role in the decisions that are made about 'my' money (a concept that is alien to the traditional trust).

While amendments to the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) have been 'bolted on' to provide for member investment choice, binding nominations and the splitting of contributions, and other legislation has been amended to introduce choice of superannuation funds, it is time for a comprehensive review of the superannuation system, to ensure that the fundamental shift in the relationship between a superannuation fund trustee and the members is appropriately recognised, accommodated and supported throughout the whole regulatory regime.

# 1 Whether uniform capital requirements should apply to trustees

The Australian Prudential Regulation Authority (APRA) Superannuation Guidance Note SGN 150.1, which was provided by APRA to assist trustees in the preparation of their application for a Registrable Superannuation Entity licence, states the following:

> "The net tangible asset requirements have a threefold purpose. They provide some financial resources to act as a buffer against risk; they evidence a commitment on part of a trustee to its superannuation business; and they act as an incentive to the trustee to manage the entity well."

In AXA's view the sole reason for capital requirements is the first reason stated above - i.e. to act as a buffer against risk.

It is important to understand the risks against which a buffer is required. In an accumulation style fund where members are responsible for investment choice, the investment risk is borne by the member. **There should be no requirement for the trustee to hold a capital buffer against investment risk.**

Operational risk is more difficult to define and measure and **it may be appropriate to impose a capital requirement on the trustee of such a fund to protect against such risk.** An operational risk buffer may be required in the event of negligence by the trustee or its agent or a significant failure of processes. In such circumstances the trustee may be required to compensate for a loss that has been incurred.

How much capital is enough?

The determining factor is perhaps not the likelihood of the event occurring but the impact - i.e. the amount of money required to compensate a loss. The impact of a risk event might be determined with reference to the number of members in the superannuation fund and the value of the superannuation fund's investments.

Risk mitigation factors also need to be considered in the determination of the level of impact. One mitigating factor may be the extent to which the trustee has outsourced its activities to professional service providers who have provided contractually binding indemnities. A further mitigation strategy would be the level of insurance cover that the trustee carries, and the robustness of the trustee's risk management framework.

Consideration also needs to be given to the capital requirements of trustee companies which are members of a larger conglomerate group. This is particularly the case where, as in AXA's case, more than one entity in the group is regulated by APRA. (The AXA group currently includes two licensed superannuation trustee companies and a registered life company.)

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

The policy behind this proposal is unclear. Currently, trustees may take the form of a group of individuals or directors of a corporation, including a proprietary company.

It is assumed that there is no proposal or consideration being given to making trustees of self managed superannuation funds public companies as this would be completely unworkable.

A public company acting as a trustee would be subject to significantly higher governance and disclosure requirements. Additional governance requirements of a public trustee company would include:

- Adoption of a company constitution
- Regular Annual General Meetings
- Appointment of Directors only by resolution at a General Meeting at which each Director would need to vote
- Directors would not be able to remove other Directors
- Directors would not be able to discuss or vote on Contracts in which they have an interest, even if they disclose the interest to the Board unless the Australian Securities and Investment Commission (ASIC) or the other Directors consent.

While all companies are required to keep financial records, public trustee companies would also be subject to more onerous disclosure requirements. The additional governance and disclosure requirements imposed on public trustee companies are associated with market conduct and relationships between the company, its members and creditors.

A company, in its capacity as trustee, is subject to the law of Trusts. A trustee company owes a fiduciary duty to the trust beneficiaries and must act in their interests. The law of Trusts operates regardless of whether the company is public or proprietary in structure. The additional disclosure requirements applicable to public trustee companies do not directly impact on the relationship between the company and the beneficiaries of its trusts.

The question as to whether or not the protection of beneficiaries of a trust could be accomplished by broadening corporate governance requirements has been considered in the courts. In *Australian Securities Commission v AS Nominees Ltd* [18 ACSR 459] Finn J questioned the necessity of such a development.

> "To the extent that it is advanced as a means of protecting trust beneficiaries from misuse by directors either of their company's trustee powers or of their own position vis-à-vis the trust property, it can be said that the protection can be afforded by other quite orthodox means and in a more extensive way".

The "orthodox means" referred to by Finn J is the law of Trusts as discussed above. Because the company itself owes a fiduciary duty to the beneficiaries, its directors must consider the beneficiaries' interests in order to avoid the risk of a claim against the company for a breach of trust. Failure to consider this risk may be a breach of Director's duties. Under section 197 of the *Corporations Act 2001*, if a trustee company incurs a claim for breach of trust and cannot pay it, its Directors must pay and they cannot indemnify themselves out of trust assets.

Since the protection of trust beneficiaries is already accomplished by the law of Trusts and other legislated general Director's duties which operate together regardless of whether the company is public or proprietary, there **appears to be no benefit in making all trustee companies public.**

Further, public trustee companies would need to recoup the costs of the additional disclosure and governance requirements. They would seek to do so by increasing trustee fees. Trust beneficiaries would then be paying the costs of compliance requirements which do not benefit them directly. At a time when there is an increased focus on reducing compliance, the Committee should carefully weigh the potential benefits of this proposal against the additional costs this measure will impose.

If the intention of the proposed change is that the members would be the shareholders of the public company, the significant potential for conflicts of interest which would follow, should be considered. For example, members may seek to advance their interests as shareholders through higher dividend distributions at the expense of superannuation fund returns.

## 3 The relevance of Australian Prudential Regulation Authority standards

APRA does not issue standards for superannuation trustees. APRA does, however, have power under section 332 of the SIS Act to issue modification declarations that 'modify' specific provisions of that Act and related SIS regulations.

APRA does issue Superannuation Circulars which enable it to provide guidance in relation to the interpretation of the SIS Act, the SIS regulations, and related matters. These Circulars can provide useful guidance. **There is no need to make compliance with Circulars mandatory or to provide APRA with the power to make mandatory standards.** APRA is not the sole arbitrator of the Superannuation Industry (Supervision) Act and Regulations and already has ample power to direct trustees through the existing licensing mechanisms.

## 4 The role of advice in superannuation

This point of reference is somewhat ambiguous. We have assumed that it relates to the provision of financial advice to superannuation fund members.

Financial advice is assuming an increasingly significant role in assisting Australians with retirement planning. The SIS Act has lagged this development and now needs to be reformed to explicitly recognise the relationship between superannuation fund members and their individual financial advisers. Any such amendments will, in turn, have implications for the relationship between a superannuation trustee and the members of the superannuation fund.

<u>Advice is needed</u>
The range and number of superannuation products has increased dramatically over recent years making the selection of a product appropriate to individual needs far more complex. At the same time, the advent of Choice of Funds in respect of Superannuation Guarantee contributions has forced many people to think, for the first time, about the superannuation fund of which they are a member and whether that fund is appropriate to their needs. The availability of Government co-contributions has encouraged more people to make personal contributions, increasing the sense of ownership that individuals have in relation to their superannuation accounts. More Australians own shares than was the case ten or twenty

years ago and this increased exposure to equity markets is alerting individuals to the wide range of different types of investments available both within and outside their superannuation fund. As a result of these developments, there is a heightened awareness of the importance of superannuation and the need to plan for the future.

The complexity of superannuation and the range of features available contribute to a greater need for advice. For example, advice may be required by a member in relation to insurance options - what type and level of cover is appropriate? Should insurance cover be taken out within or outside of the superannuation fund? Binding death benefit nominations and estate planning are other matters to be considered. Advice may also be required in relation to specific events such as divorce, disablement or terminal illness.

The global AXA Group undertook a research project in 2005 which examined people's attitudes to retirement and saving across twelve countries. The following points represent findings relevant to Australian survey participants:

- Working Australians' ideal retirement age is 54
- Their anticipated actual retirement age is 62
- On the one hand they are looking forward to retirement, and are planning to be active.
- On the other hand, only 49% anticipate that their retirement income will be sufficient to enable them to do the things that they want to do.

Research undertaken several years ago by the Association of Superannuation Funds of Australia (ASFA) indicated that Australians had unrealistic expectations of their standard of living in retirement. More recent research by ASFA and separately by the global AXA Group indicates that this is no longer the case. While Australians still have high expectations of retirement, large numbers of Australians recognise that these expectations may not be achieved.

Increasingly, working Australians are looking for ways to close this gap between where they want to be in retirement and where they expect to be. Financial advice has a crucial role to play in helping individuals to achieve this objective.

Planning earlier

There has been a trend among Australians to start planning for retirement in their 50's. Across the superannuation industry there is general consensus that people need to start planning for retirement earlier. The Federal Government's recent proposals to cap the level of contributions that can be made in any one year are clearly aimed at encouraging people to contribute more evenly to superannuation over their working life.

AXA research shows that of the working Australians who have already begun to prepare for retirement, the average age at which they started planning was 33. This represents an earlier age for planning commencement – people who have already retired indicated that on average they started to prepare at age 40.

So Australians are starting to prepare for retirement earlier, but how are they doing this? Our research shows that 57% of working Australians have sought information or advice about retirement. 87% of this group sought information or advice from private sector sources such as insurance companies, banks, financial advisers, and brokers.

This research indicates a strong interest in planning for retirement. Yet the number of working Australians who have prepared a financial plan with a professional adviser is much lower.

Planning in context
Planning for retirement needs to be holistic and is not just about what superannuation fund or investment product to choose. Today there is about $905 billion in superannuation and a similar figure ($909 billion) in personal debt. Advise is critically important to ensuring benefits of retirement savings are not offset by other financial decisions that are inconsistent with the objective of funding a long and happy retirement.

Paying for advice
The Financial Services Reform amendments to the *Corporations Act 2001* (FSR) have had a significant effect on how financial advice is provided. The standard of advice provided to consumers is now higher; the documentation is more detailed (and certainly more voluminous) and the penalties for the provision of unlicensed or inappropriate advice are substantial.

While the standard of financial advice has been raised, the cost of obtaining financial advice has also increased.

If Australians are to make adequate preparations for retirement, they need to plan. This means developing a personalised financial plan, and in our view this is best done in conjunction with a qualified, professional financial adviser.

More needs to be done to increase access to financial planning services, and at an earlier age but undoubtedly one of the barriers to such access is the cost. During the earlier stages in life, when people are purchasing a house and starting a family, they have less disposable income and more competing demands for the money that could be spent on financial advice. Many individuals are reluctant to obtain financial advice because of the up front cost of doing so, and yet decisions made during these earlier stages in life can be critical to a family's future financial wellbeing.

AXA supports the individual's right to choose how they pay for advice.

## 5 The meaning of member investment choice

## AND

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

These two points of reference will be addressed together.

Very simply, member investment choice is about enabling the member to choose investments from a 'menu' of investments determined by the trustee.

Member investment choice has been introduced in response to consumer pressure from members, and is linked to two trends.

The first of these trends is the rise of accumulation style funds. In an accumulation style fund, the investment risk is borne by the member.

The second trend is the increasing level of member activism. Mandatory employer contributions have resulted in higher superannuation accounts balances. Increasing numbers of members make voluntary contributions to superannuation funds. Also

increasing is the number of members approaching retirement with sizable superannuation assets. As a consequence, more members are starting to think about superannuation, and to regard it as 'my money'.

With this increased exposure to market risk and a greater sense of ownership comes an increasing desire to be involved in decision making regarding investment choice.

Facilitating selection

The primary role of the trustee in the member investment choice environment is to facilitate the selection of investments by a member. This is achieved through the provision of a 'menu' of investment options' which is broad enough to accommodate the investment needs and risk profiles of the superannuation fund's membership. The trustee can add value by ensuring that the quality of the investments available on the menu is high and by providing access to investments at a competitive price. The trustee has a secondary role in making a default selection in circumstances where the member has either not provided investment instructions or is unable to do so.

The role of the trustee in managing investment risk for members in an investment choice environment is complex. The extent to which the trustee manages the investment risk will vary, depending on a member's individual needs, expectations and level of expertise.

Many members seek an environment in which the trustee manages much of the investment risk on their behalf. To these members, the trustee may offer a relatively small number of diversified investment portfolios which correspond to different risk profiles. The options available are readily able to be distinguished and the description of the asset allocation and investment objective relevant to each option will assist even the relatively unsophisticated member to make a choice. The trustee will actively manage the underlying investments and asset allocation within the diversified portfolios in response to market conditions and other factors.

Other members seek a superannuation fund that offers a large menu of investment options. These members typically have a higher than average level of market expertise or have engaged a financial adviser to assist with investment selection as part of a financial plan. In this environment the trustee's role in managing investment risk should be limited to providing an appropriate range of investments for selection.

One problem with the current regulatory environment is that the SIS Act explicitly recognises member investment choice, but APRA still expects the trustee to second guess a member's investment choices and to intervene in circumstances where the trustee does not believe the member's investment choice is prudent.

In circumstances where a large menu of investment options is offered, APRA requires that the trustee formulate an investment strategy at fund level (which is entirely appropriate) and that the trustee formulate member investment strategies at the individual level. In its first, draft, revision of Superannuation Circular II.D.1 *Managing Investments and Investment Choice*, APRA proposed a requirement for the trustee to monitor individual member investment choices. In circumstances where the trustee deemed the investment choices made by a member to be inappropriate (because of inadequate diversification for example) APRA required the trustee to override the member's investment choice and impose its own selection.

AXA responded to APRA's draft revision of this Circular with the following submission:

> "We would, however, like to stress our concern about the failure of the draft Circular to appropriately recognise the role of professional financial advisers in protecting and enhancing their clients' retirement savings and incomes.
>
> We refer to the requirement that the trustees of superannuation funds formulate investment strategies at the individual member level for all members in order to ensure appropriate diversification of investments for individual members.
>
> Where a member has not had the benefit of professional financial advice this may, in some circumstances, be a sensible measure. However trustees do not and cannot have available to them all of the information relevant to each individual member's personal circumstances that is required in order to provide personal investment advice to individual members. Furthermore, in most cases, trustees do not have the regulatory capacity to provide such advice to individual members. The provision of individual investment strategies to members by trustees runs a poor second to obtaining professional personal financial advice.
>
> In circumstances where a member has received professional financial advice the imposition by a trustee of restrictions on the investment choice able to be exercised by the member is unnecessary and potentially damaging...."

In the last five years a very significant investment has been made by the Australian Government, industry regulators and industry participants towards raising the standard of professional financial advice provided in Australia. Higher educational and ongoing training requirements, greater disclosure, improved documentation, clarification of the distinction between general and personal advice and increased monitoring and enforcement of standards have served to both improve the quality of financial advice and to highlight the importance and benefit of personal financial advice.

Trustees are not necessarily licensed for the provision of personal financial advice and don't necessarily have the expertise for the provision of personal investment advice. Yet the proposed APRA Superannuation Circular II.D.1 is proposing that trustees override investment decisions made by members who have sought professional and personalised financial advice. This raises significant regulatory issues. If trustees are to be required to override investment decisions what training and infrastructure will they be required to acquire or insource, and at what additional cost to members? How should trustees communicate a decision to override investment choices to the affected member? What further licensing should be required to regulate this new, quasi-personal advice role?

Financial advisers conduct several interviews with clients before providing financial advice and are cognisant of a member's personal investment objectives, his/her complete financial profile (not just their investment in superannuation) and his/her individual needs at the time that they do provide the advice. Financial advisers understand their client's approach to investing and their individual appetite for investment risk. The recommendation provided by a financial adviser in relation to a member's superannuation investments will take into account all of this information and will also consider the assets and investments that the member holds both in other superannuation funds and outside of the superannuation environment. Trustees, on the other hand, have little or no information upon which to base a

decision which would over-ride an adviser's recommendation and quite possibly disadvantage the member. It is completely inappropriate in this context to place the burden of providing individual advice upon the trustee. It is completely at odds with the philosophy behind the introduction of member investment choice and the choice of superannuation funds.

APRA has subsequently issued a final Circular which does not contain a requirement for the trustee to override a member's investment choice. However, the trustee is still required to monitor individual member's investments and to issue 'health warnings'.

Despite this change, the tension between the trustee's obligation to protect the individual member's interests in relation to his/her investment selection and the member's right to select investments which he/she believes best suit his/her personal financial circumstances still exists.

*AXA proposes that section 52(4) of the SIS Act, which permits member investment choice, be modified to make it clear that where an individual member provides a direction under this section the trustee does not have a responsibility to ensure that the selected investments are suitable to the individual member's financial circumstances and objectives.*

Such an amendment would make it clear that the trustee's obligations in relation to investment strategies is to 'formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the entity' as required by section 52(4) but does not extend to consideration of the individual financial circumstances of the members. This will provide an appropriate balance between the trustee's fiduciary responsibilities on the one hand and the exercise of individual investment choice on the other.

Trustees would still be free to impose other controls where they are considered appropriate- for example only allowing a member to invest in a particular investment option in circumstances where they have obtained financial advice.

There are currently a number of restrictions imposed by the legislation and/or by APRA on the types of investments that can be offered within the superannuation environment. To the extent that these restrictions are designed to prevent investments which could be used to circumvent the retirement purposes of superannuation (eg. some of the in-house asset rules) this is appropriate. To the extent however that these rules are designed to protect funds against market risk the rules are not appropriate - particularly in a member choice environment. Such rules also have the capacity to unreasonably exclude some investment types while favouring others, inhibiting market efficiency.

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

The investment assets available to Self Managed Superannuation Funds (SMSFs) are significantly more diverse, and include business real property. Business owners can transfer their own business assets – for example, a factory – into an SMSF, where it is taxed at 15% on the income, while the business claims a tax deduction for the rent paid. More unusual assets such as futures and instalment warrants may also be held through an SMSF, as may non-traded assets such as collectibles and investment properties. Many larger superannuation funds cannot or will not allow such assets to be held.

SMSFs can offer an enhanced ability to pass wealth between generations. For example, not only can the member stipulate to whom a death benefit will be paid, he/she can also stipulate that it is to be paid as a pension to a dependent rather than a lump sum. Typically, larger superannuation funds may offer binding death benefit nominations but they do not typically allow the method of payment to be specified.

One of the principle reasons for the growth in SMSFs is 'control'. The increased level of control that can be exercised by the members of an SMSF increases the scope for SMSF's to be abused. Simultaneously, the lack of expertise of many SMSF trustees can lead to significant problems with compliance. *AXA urges the committee to consider introducing a requirement for a minimum level of expertise among SMSF trustees.* This could be achieved by requiring each SMSF to have at least one trustee or director who meets minimum requirements for knowledge and expertise in specific areas such as superannuation law and investments - similar to the British model which requires the appointment of a registered 'pensioner trustee' to self administered schemes. This person could be exempted from the requirement to be a member of the fund. While acknowledging that this would place an additional burden on SMSFs, AXA believes that this proposal is worthy of consideration, and would significantly reduce the scope for abuse and maladministration which exist in the current SMSF regime.

Another reason for the growth of SMSFs is the increase in the average superannuation account balance. SMSFs are generally not considered to be viable unless a member's account balance is approximately $200,000 or more. The growth in superannuation account balances in the last decade has resulted in an increasing number of people for whom an SMSF is a viable option.

A further factor in the growth in SMSFs is dissatisfaction with investment performance. Research by Investment Trends and separate analysis undertaken by AXA suggests that the rate of establishment of new SMSFs increases when equity markets fall. At these times, the individuals establishing the SMSF believe that they can manage their superannuation investments better than their current superannuation provider. However, there is no evidence to suggest this is the case which is another reason why financial advice plays a crucial role in helping investors make appropriate decisions based on an objective assessment of facts.

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

AXA has no submission to make in relation to this point of reference.

# 9 Cost of compliance

AXA recognises that the financial services industry deals in complex and intangible products and that while these products are of vital importance to individuals and to the Australian economy they are poorly understood by many consumers. For this reason, the level of regulation of this industry needs to be significantly greater than for many other industries, and the cost of compliance must also be relatively higher. There is, however, significant scope for reducing the cost of compliance without reducing its effectiveness. The dual regulation of superannuation by ASIC and APRA, and the dual licensing requirements imposed on public offer superannuation funds are good examples of areas where cost savings could be made.

Dual regulation

In theory, there is no overlap between the regulatory roles of APRA and ASIC in relation to superannuation - one is responsible for prudential management while the other deals with market conduct. The reality is very different.

Both ASIC and APRA conduct reviews of superannuation trustees. While the purpose of the review may be different, the subject matter is often the same - for example reviews of complaints handling, or of the Board of Directors' operations. On several occasions over the last twelve months, AXA has provided large volumes of material relating to our superannuation funds and the trustees to one regulator, and then provided the same material to the other regulator at a later date.

The longer term solution to this issue is to move to a single regulator of financial services, combining the roles currently undertaken by APRA and ASIC. In the medium term, greater differentiation of the roles and responsibilities of the two regulators and a reduction in the amount of dual regulation would be helpful.

*In the short term, significant reductions in compliance costs could be achieved through greater co-operation between the regulators and a combined approach by the regulators to their dealings with entities, including:*

- *co-ordination of regulatory activities and calendars*
- *joint conduct of reviews where responsibilities overlap*
- *streamlining of policies relating to common areas such as outsourcing, responsible persons/officers and whistleblowing*
- *sharing of information and greater co-operation between the regulators.*

Self Managed Superannuation Funds and the ATO

The picture is further complicated when Self Managed Superannuation Funds (SMSFs). While largely governed by the same law as other superannuation funds, the primary regulator of SMSFs is the ATO. While the decision to appoint the ATO as the regulator of SMSFs may be convenient there are real questions about whether it was appropriate. SMSFs now hold approximately 23% of all superannuation assets. In a speech on 1 March this year the Commissioner of Taxation, Michael D'Ascenzo, stated

> *Our focus is on whether fund investments are in accordance with trustees' stated investment strategies and in accordance with the SIS Act, but it is not our role to look at the overall soundness of the investments from a business perspective.*

This is in contrast to APRA's approach to other superannuation funds which places a greater emphasis on prudential regulation. Notwithstanding the more significant role that members of SMSF s have in their fund's administration, the question remains whether it is appropriate to allow such a large sector of the superannuation industry to operate without prudential regulation.

Dual Licensing

Not only are superannuation funds regulated by both ASIC and APRA, but public offer superannuation funds are required to be licensed by both of those regulators.

Following the introduction of the Financial Services Reform amendments to the Corporations Act, a trustee of a public offer superannuation fund typically needed an Australian Financial Services Licence (AFSL) to:

- provide general advice; and
- deal in superannuation products.

The requirement for a superannuation trustee to be licensed to provide general advice in relation to its own products was removed in 2005 as part of the Financial Services Reform refinements package. As a consequence, most public offer trustees now only need to maintain an AFSL in order to deal in superannuation products.

As a consequence of the dual licensing arrangements, trustees of public offer superannuation funds are required to quote both an AFSL number and a Registrable Superannuation Entity Licence Number (as well as an ABN) on most documents. They also need to maintain different 'responsible person' registers (one for each regulator) and they must meet two different sets of reporting obligations.

While only licensed by ASIC in respect of dealing in superannuation products, a trustee's reporting obligations to ASIC are onerous. The reporting requirement is not limited to dealing in superannuation products but covers the trustee's other (non-licensed) activities across a wide range of legislation.

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

The most effective way to address the cost of dual licensing is to remove the requirement for trustees of public offer superannuation funds to be licensed by ASIC to deal in financial products (a minor amendment to Corporations sub regulation 7.6.01(1)(a)). This would eliminate the duplication without reducing the effectiveness of the regulation of these entities. Importantly, a trustee of a superannuation fund would still be obliged to comply with the relevant provisions of the Corporations Act even if it was not licensed under the Corporations Act.

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

Materiality/significance

There is currently no materiality test relevant to the reporting of breaches to APRA. There is no regulatory or policy value in requiring all breaches to be reported regardless of materiality. Such an approach is contrary to modern risk management and compliance practice, and increases compliance costs. Rather than assisting APRA to identify important issues and themes it has the effect of diverting resources from important issues.

If the dual reporting obligations are to continue, a consistent materiality test should be introduced across the requirements to report breaches both to APRA and ASIC. This test

should be based on a range of factors including the impact to individual product holders/clients, the number of product holders/clients impacted, the impact on the overall superannuation fund and the ability of the trustee to make good any loss.

If the dual reporting requirements are to be removed, a materiality test similar to that contained in section 912D of the Corporations Act 2001 should be introduced in relation to breaches reported to APRA.

## 10 The appropriateness of the funding arrangements for prudential regulation

AXA has no submission to make in relation to this term of reference.

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

AXA does not see the need for any change to the current legislative arrangements in this regard.

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

AXA has no submission to make in relation to this term of reference.

## 13 Benchmarking Australia against international practice and experience

AXA has no submission to make in relation to this term of reference.

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

AXA has no submission to make in relation to this term of reference.

## 15 Any other relevant matters

Is the trustee structure still relevant?

In some significant aspects the typical superannuation fund trustee no longer resembles the trustee of equity law. Members have been given greater power to direct trustees, (investment choice, binding death benefit nominations, the right to withdraw from the fund at any time) and yet there has been no concomitant reduction in the level of duty the trustee owes to members. This leaves the trustees in the invidious position of bearing all of the responsibility for the members interest in the superannuation fund without having the discretion or power necessary to meet these responsibilities.

The SIS Act needs to be amended to more clearly delineate the rights, powers and responsibilities of both the member and the trustee, and to protect the trustee where it acts on a member's legitimate instruction. In such a modified form the trust structure can continue to be a relevant and appropriate vehicle for superannuation.

Compensation for trustee errors

Superannuation funds undertake large numbers of complex transactions every day. AXA acknowledges the need to compensate members for errors and the legislative obligation to notify members where errors are significant.

There is currently some uncertainty, however, as to whether compensation must be paid in all cases, regardless of the amount owed to any individual client.
ASIC has expressed the view that compensation must be paid in all cases, regardless of the amount owed. AXA does not support this view. When ASIC's view is taken to its extreme, it is detrimental to members' interests. This is particularly the case with former members. Payment of compensation to these members can, for example, involve contacting them to seek instructions for the rollover or transfer of very small amounts to another superannuation fund. Even assuming the other fund is prepared to accept the small amount, the cost and inconvenience to the former member can outweigh the benefit.

While we appreciate the critical role of disclosure in ensuring a transparent and efficient market in financial services, we question the benefit of writing to customers about trivial amounts. Such communications are unlikely to influence investment decisions, serving merely to add to the increasing volumes of correspondence from financial institutions demanding customer's attention, while unnecessarily increasing business costs and annoying customers.

*There is a strong argument for allowing the industry to adopt a compensation and communication strategy in relation to errors that protect members' interests but which avoids the unreasonable expense imposed by a requirement to compensate and communicate in all cases without consideration of the cost and effort for doing so.*

Product Rationalisation

IFSA and its members have undertaken significant work in the last 2 years in identifying barriers to the rationalisation of financial services products. This has included examining the barriers that exist to the rationalisation of superannuation funds.

The rationalisation of superannuation funds can provide several benefits, including:

- better product disclosure and clearer reporting
- lower product cost structure. Some of the resultant cost savings from efficiencies gained through product rationalisation programs will be passed onto consumers
- enhanced and newer features. Eg. BPay, internet/online transactions, investment choice, unbundled offerings, more transparent and easier to understand products
- improved service standards through better administration, greater flexibility, fewer systems and processes.

Such benefits result principally from greater economies of scale and transfers to more modern and flexible products and systems.

There is an existing process for product rationalisation through the use of a successor fund transfer (SFT). There are currently two significant problems with this SFT mechanism.

The first is that a SFT triggers a liability for Capital Gains Tax. If the superannuation funds involved in the SFT have made capital gains on their investment holdings, there are circumstances in which members must be compensated for some or all of this tax in order to achieve equivalence. If the superannuation funds have accrued capital losses, which could have been used in future years within the existing fund, these are lost upon transfer, triggering a further requirement for the trustee to compensate members in order to achieve equivalency. *AXA suggests that CGT relief for SFTs would facilitate greater use of the SFT provisions contained in the SIS Act. Such a proposal is revenue neutral to the Federal Government as CGT will be paid by the successor fund on the same basis that it would have been paid by the transferring fund if the SFT had not occurred.*

The second problem is that there is a lack of certainty around the 'equivalent rights' requirements. While in theory these requirements are relatively simple, the test is actually quite difficult and ambiguous to apply in practice. IFSA has proposed a 'no detriment' test which would, we believe, significantly improve the scope for product rationalisation in the superannuation industry without disadvantaging members. AXA supports the IFSA proposals in relation to Product Rationalisation.