PASL

15 September 2006

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

Dear Mr Sullivan

Inquiry into the structure of the superannuation industry

Submission by the Recruiting and Consulting Services ("RCSA") and the Professional Associations Superannuation Limited ("PASL")

Introduction

The RCSA is the peak industry association for the recruiters and suppliers of part-time, casual and on-hire labour to commerce and industry. The RCSA therefore plays a major role in representing employers who are responsible for supplying labour in the fastest growing sector of the labour market, the on-hire sector.

In its role as a major representative of labour recruitment agencies the RCSA is also the sponsoring employer association of the Recruitment Services Superannuation Fund ("RecruitmentSuper"), a public offer industry fund that caters especially for the superannuation needs of part-time, casual and on-hire workers. PASL is the Trustee of RecruitmentSuper.

RecruitmentSuper was established in 1992 by the RCSA's predecessor, the National Association of Personnel Consultants, and provided casual, part-time and on-hire workers with a single fund to which they could contribute regardless of which employer they worked for. It also gave many workers in this category a solution

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to the problems caused by changing funds with each change of employer, including the creation of multiple accounts and multiple fees, well before the introduction of the choice of fund regime.

We believe our experience and success in providing a stable superannuation environment for a significant portion of the labour force that because of its mobility, was effectively discriminated against by the superannuation system, means that we are able to comment authoritatively on the current structure of the superannuation industry.

The superannuation system is now such a significant part of Australia's savings environment that it is in the interests of all, the members, the funds and the Australian economy that ongoing assessment of the system continues. We believe that inquiries, like this one, provide the opportunity to assess the success or otherwise of the current superannuation framework and we welcome the opportunity to make this submission to it.

Although to date there have been no major catastrophes in Australia on the scale of the failure of pensions funds in the US, Enron being a sobering example, or a major financial advice scandal as occurred in the United Kingdom, there have been some failures of the system, for example, Commercial Nominees. This is strong evidence that all effort should be devoted to ensuring that contributors to superannuation funds can invest with confidence in a secure system which has sufficient transparency to enable them to make educated and informed choices in a competitive market.

It must always be kept in mind that contributing to a superannuation fund is compulsory in Australia – members do not volunteer to hand their money over to be invested on their behalf – they are required to do so by law. This is yet another reason why the managing of investments in the superannuation system needs to be transparent to those who have a stake in it. Australians ought to be able to make educated and informed choices about the fund in which they invest their money for retirement.

Superannuation is a major policy issue for government, not least because for most Australians their superannuation is the second biggest asset they hold beyond the family home. For many it is the only other asset beyond the family home, and for some, a small minority, the only asset. Superannuation should enable all Australians to look forward to a comfortable retirement and significantly reduce reliance on the age pension. This is why it is so important to ensure that the superannuation system provides Australians with the best opportunity to save for their future, and in particular, for their retirement.

There is little doubt that Australia faces challenges, although not on the same scale as most comparable European countries, as the population ages. This means that the superannuation system must be as efficient, effective and as safe as possible to ensure that retirement benefits are maximized. We believe that this can be best achieved by the establishment of a highly competitive market in superannuation products and with this in mind we would like to address the terms of reference of this inquiry.

1. Uniform Capital Arrangements

At present all pubic offer and extended public offer funds are required to have capital of at least $5,000,000 or provide other equivalent forms of security in order to get a Registrable Superannuation Entity (RSE) license. The existing capital requirements for public offer funds are designed to provide some protection for fund members when members' assets are lost through negligent management.

Non-public offer funds are not subject to capital requirements but instead must meet a number of tests set out by APRA in SGN 140.1 – Adequacy of Resources. In this guidance note it is stated that a major reason for not setting a capital requirement for non-public offer funds is because of the structure of such funds. That is, that they are not set up to make profit in the usual sense of the word.

This means that in order to meet capital requirements the fund would have to use member's funds that would otherwise be invested, and earning income, for members. Other reasons include the inability of these funds to raise capital or borrow under the rules of superannuation.

Nonetheless in the new choice environment, all funds whether public offer or non-public offer, have to compete in a market where choice is an integral part of the superannuation system. This means that most funds provide greater choice of investment, which entails investing in areas of greater risk than previously occurred. Funds also usually allow members to make additional choices in relation to other services such as insurance. In this environment the risks are much higher and there is a need to ensure that if funds are lost because of the actions of the trustee there is provision made for compensation where it is justified.

We agree that in the case of some of the small to medium non-public offer funds the raising of at least $5,000,000 or obtaining an acceptable guarantee would be difficult, but we were inclined not to agree in relation to the larger non-public offer funds. We considered it might be arguable that funds that hold assets above a set amount ought to be subject to capital requirements although we do not necessarily agree that those requirements should be uniform.

In order to do this the current rules in relation to superannuation would need to be changed to permit either the use of member funds or to borrow to raise the appropriate capital. On the other hand we do not think that this would be in the interest of the members of the funds in that it would use money that would otherwise be invested and earning income.

In the case of small to medium funds that are non-public offer funds, we believe that adequate insurance against negligent and other losses of members' funds ought to be compulsory and that the levels of insurance be related to the size of the fund. Although this would be a cost to the members, it could be expected to be less than the cost of setting aside a large amount of the members' money for a capital reserve.

We have concluded therefore that although there is some merit in having capital requirements, we do not believe it would be fair on the members of the affected funds that a significant part of the money they contribute for investment is used to create a reserve. We therefore take the position that the best approach is to ensure that all funds have in a place appropriate insurance which takes into account the size of the assets and the risk profile of the particular fund.

Recommendation: That compulsory insurance should be introduced to ensure that all funds are able to compensate members who have suffered a financial loss caused by trustee negligence and failures of duty.

2. Trustee – Limited Company or Public Company?

The fact that trustees manage superannuation and pension funds established in Australia, the UK and the US, is not an accident of history. The duty of a trustee towards a beneficiary - in the case of a superannuation fund the member of the fund - is the highest fiduciary relationship under the law. A Trustee of a superannuation fund must always act in the best interests of the members of that fund.

In these circumstances we can see little advantage in the trustee - the trustee company as a limited company - being replaced with a public company. This may mean that the disclosure requirements of public companies would replace the more limited ones of a limited company, but the disclosure would be to shareholders not to members. It would also result in a substantial increase in compliance costs.

There is in fact nothing to be gained by members from the change to a trustee with public company status. If it is believed that the current disclosure regime in superannuation is inadequate we suggest that the disclosure rules relating to superannuation trustees be amended to make for greater disclosure.

We would also point out that the there is an urgent need to simplify the current system, the complex nature of which, places a heavy burden on the trustee and raises issues about the relationship between the Trustee and member. It is our opinion that it is arguable that the relationship has become far too paternalistic towards the member.

An example of paternalism combined with complexity in the current system, that we would like to bring to the attention of the Committee, involves the rules relating to the distribution of benefits on the death of a member.

The distribution of benefits on death remains at the discretion of the trustee unless the member has put in place a binding nomination as to the destination of the benefits on the member's death. It is our opinion that it is not the role of the trustee to decide where the benefits of a deceased member should be paid any more than it is the role of the trustee of a deceased estate to make those decisions.

It is paternalistic because it assumes that the member is not competent to decide where death benefits should be directed. It is inefficient because there are two trustees involved in handling a deceased persons assets – the fund trustee who must decide who are dependents for the purposes of the death benefits and the trustee administering the balance of the estate.

The complexity of the situation is further illustrated by the fact that the fund trustee must take into account the distribution of the estate when deciding on the distribution of death benefits, even if that estate is under challenge. We would recommend that this aspect be rationalized so that a death benefit is directed into an individual's estate and that any dispute about beneficiaries should be decided under the relevant law governing deceased estates.

The only possible rationale for the current situation is taxation, but we cannot see why taxation law cannot be amended to apply to superannuation as an asset of the deceased member's estate.

Recommendation: That the Trustee remains a limited company but that the paternalistic nature of the relationship between the Trustee and the fund member be reviewed.

3. Australian Prudential Regulation Authority ("APRA") Standards

The APRA standards are found in both the Superannuation Industry (Supervision) Act 1993 ("the SIS Act") and SIS Act's accompanying regulations. Given the importance of superannuation to Australians, the superannuation regulatory system must provide a safe and secure environment for the accumulation of savings for retirement.

It is our opinion that the standards set out in the legislation and regulations, in addition to those already imposed upon trustees by the general law, provide a good framework for regulating superannuation funds. We do not in general see them as unreasonable restrictions. Under these rules, Australian superannuation funds are still able to invest in quite diverse investment products and adequate protection can be provided through disclosure to members and prospective members of a fund. But we also see the rules as evolving to take in some of the issues dealt with elsewhere in this submission such as the payment of fees for financial planning out of superannuation accounts as discussed in Reference 4 and the ability of funds to pay for advertising discussed in Reference 11. The standards will also need to take into account the likely development of new superannuation services, such as post-retirement accounts that operate in a similar manner to a bank account.

Nonetheless we are of the opinion that there is a need for greater disclosure in both the accounts and PDSs available to all members and the public so the public can gain a greater understanding of the nature of the expenses of funds under the choice of fund regime including the amounts paid out of the funds and to whom these amounts are paid. We also see a need for members to be able to compare costs between all available funds and suggest that the government establish a national database showing the comparative costs of all complying funds.

Recommendation: That the government develops a national database containing key financial information to enable comparisons of fund financial management.

4. The Role of Advice in Superannuation.

There is a role for advice in superannuation, particularly at the retirement end, when members retiring will often require advice on the best way to use the proceeds of their superannuation savings. Unfortunately there are a number of issues surrounding the financial advice industry that need to be resolved in regard to advice and superannuation.

We believe that consumer education, together with transparency in relation to the management of the fund, is important to the task of selecting the fund into which an individual should contribute. Nonetheless we recognize that in some cases individuals will either need or want to seek advice on that choice. For instance, some people might require more comprehensive advice, particularly where investment choice is concerned, in circumstances where they already hold other investments outside the superannuation system.

There are a number of additional issues that we believe need to be addressed in relation to advice. These include at least the:

- independence of financial advice;
- cost of advice; and
- manner in which that advice is paid for.

We also take the position that it is more financially beneficial for a member to pay for financial advice "up front", rather than be burdened with the ongoing fees of advisers paid on a commission basis. Unfortunately many people cannot afford to pay "up front". However such people might be able to pay "up front" if it were possible for members to authorize payment from their superannuation account.

At present it appears that the Sole Purpose Test may present a barrier to using money from accounts to pay for advice. We believe this situation should be clarified and argue that this method of payment is preferable to the alternative situation where a fund provides free financial advice to members. The problem that we see arising from providing a free advice service is that not all members need to use such services, a situation that we believe is unfair.

There is also the potential for a conflict of interest arising when the fund employs its own advisers, just as occurs when advisers attached to financial institutions such as banks and fund managers provide advice. Proper disclosure in relation to conflicts arising in the financial planning situation is also a concern in that the current disclosure documents are now so lengthy and complicated that it makes it difficult for many fund members to understand the arrangements they are entering into. We believe making them simpler and clearer is to be recommended.

We suggest that there is a place for an abbreviated advice disclosure document that captures the main points, in particular the real effect of fees and commissions, which a consumer needs to know about the financial product or products in which they are interested in investing. We would use as an example of

how a quite complex issue can be summarized effectively, the way in which the National Privacy Principles efficiently encapsulate the Privacy Legislation.

In the case of financial advice, the longer document should remain available to the consumer who wishes to go beyond the information contained in the abbreviated version, but experience shows that at present the document is of such length and complexity that the average consumer has great difficulty with it, to the extent that many do not bother to read it – and this includes ASIC's shorter form disclosure document which can also run to more than 20 pages. Obviously in these circumstances an abbreviated document providing essential information, with the option to read the longer version is a preferable alternative.

We also take the view that there is a place for advice that is targeted only at superannuation. As we have mentioned earlier, for a large number of Australians superannuation is the only asset other than the family home. Individuals in this situation do not need the comprehensive advice that a financial advisor is obliged to provide at present. With comprehensive advice there are substantial expenses for a consumer who may only need advice about one or two matters such as choice of fund and/or choice of investment.

Recommendations:

- **That a more simplified and abbreviated form of disclosure than currently provided for under the Corporations Act be introduced to assist consumers assess superannuation and post-retirement products.**
- **That financial advisers should be able to give advice limited only to superannuation where that advice is the consumer's only need, and that the costs of such advice ought to be paid up-front from the consumer's superannuation account if the consumer so chooses**.

5. The meaning of member investment choice

Member investment choice allows a member to choose from a selection of investment options that a particular fund has on offer. The present situation is that some funds offer only a limited number of choices whereas other funds have very diverse choices.

Investment choice, together with the ability to choose a fund, provides a lot of flexibility for the member with specific investment needs. If the member's current fund does not provide the type of investment the member wants, in the majority of circumstances the affected member can move to a more suitable fund with different investment choices. There still remain some issues of concern that we believe need to be addressed. First, we are concerned at the limitations in choice for members who are not able to choose a fund, and second, the possible limits on investing in discrete assets.

Members who are not able to exercise choice of fund are limited to the choices available within one fund only, which severely limits their choice. We recognize that the Federal Government has with its Work Place Relations changes partly alleviated this situation for employers who are constitutional corporations but there is still a small minority of employees at state level who cannot exercise choice of fund. Although this is not a Federal issue, we would urge the Federal Government to continue to encourage the states where this occurs to consider changing the relevant State law to bring it into line with Federal Law and allow all Australian's choice of fund.

We were for some time concerned about APRA's proposed approach to investment by members in discrete assets or a single but volatile asset class. APRA has since set out its views on discrete investments in Superannuation Circular II.D.1 released in March 2006. We are pleased that APRA has listened to the concerns of stakeholders in the superannuation industry and has withdrawn from its earlier position as stated in the former draft of this circular, and we agree that the trustee has both common law and statutory duties that must be met in the interests of fund members and that the guidelines may prevent some members from investing in the investment of their choice.

The fact that the trustee may not be able to provide all the investments that are available is not a major barrier to choice. Where a member wishes to invest their superannuation contributions in a discrete asset or volatile asset class that is not provided by any regulated fund, we believe that the member should be advised to pursue their investment preference through the use of a Self Managed Fund (SMF).

Recommendations: That the Federal Government continues to encourage State Governments to allow choice of fund to those non-constitutional entities that are not subject to the choice of fund regime.

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

The responsibility of the trustee in a member investment choice situation is to provide choice within the limitations of the fund. Larger funds will obviously be in a better position to provide more choices but in the context of choice of fund, as explained in the previous section, this is not as limiting as it might first appear. Effectively, the role of the trustee is to ensure the correct balance of investments to support the choices that the fund offers, and to ensure sufficient liquid assets are available to meet the fund's ongoing payment obligations. Our view is that the trustee's responsibilities should go no further than offering a range of choices and ensuring that these are true to label and managed appropriately. The trustee's responsibility

does not and should not extend to monitoring of an individual's choice and whether such choices are appropriate.

This system of choice is effective for most Australians but there does remain a significant minority for whom it creates some problems. An early concern for us was that the legal duties placed on the trustee can operate to limit choice for those members - we have already raised the issue of the member who wishes to invest only in a discrete and possibly risky investment, for instance a single equity or a particularly volatile asset class.

Nonetheless, an alternative is available for members seeking to invest in unusual assets or assets with a risk attached that the Trustees find unacceptable in the context of a fund, that is, the SMF. As this alternative is available we believe that the current role of the trustee in the context of member investment choice is appropriate for regulated funds and recommend no change.

Recommendation: That the trustees responsibility in a member investment choice be to ensure a correct balance of investments to support the choices the fund offers and to ensure sufficient liquid assets to meet the fund's ongoing payment obligations.

7. The Growth of Self Managed Funds

There are a number of reasons that have contributed to the growth of self-managed funds. The reasons include:

- The intense marketing of SMFs by Accountants and some financial institutions.
- The wish by many to be able to manage their own money.
- The supposed flexibility and control that SMFs provide.
- The ability to invest in assets not otherwise available in a regulated fund.
- Estate and tax planning advantages.

There are though some disadvantages in SMFs for the unwary - which include the ongoing cost of administration and compliance - this situation is improving with the introduction of better technology to manage SMFs. In addition, some SMFs have been set up on the advice of accountants and other professionals, with insufficient investment to make them viable investment vehicles. But in general, for those with sufficient assets and the desire to personally manage them, SMFs provide an excellent vehicle for saving for the future.

Nonetheless, we believe that the SMF regime would be significantly more efficient if there was a minimum investment level required for the establishment of an SMF. It is well known that SMFs with insufficient capital can result in negative returns because the costs of managing the fund are higher than the investment returns. Setting up a minimum level of investment would mean that individuals could not be tempted into investing unrealistically small amounts in SMFs by unscrupulous advisers and accountants interested in the fees they obtain rather than their client. There should also be sufficient funds in an SMF to allow an appropriate investment spread to reduce risk.

We do suggest that if a minimum amount is set in place that an exception be permitted, and an amount below the standard minimum allowed where a licensed financial planner has signed off on a cost/benefit analysis, which fully justifies the lesser amount.

We would also point that this approach would also significantly reduce the burden of SMFs on the resources of the Australian Taxation Office ("the ATO") saving the government considerable money.

Recommendation: That a minimum investment balance of $100,000 be established as a prerequisite to the establishment of an SMF except where a lower figure has been proposed by a licensed accountant or financial planner, and a cost/benefit statement justifying the lower amount is included in the Statement of Advice

8. The demise of defined benefit funds

The demise of the defined benefit fund is not confined to Australia. In the UK the defined benefit fund is also in rapid decline. This is partly due to the reluctance of both companies and governments - the predominant sponsors of defined benefits funds - to continue to fund the considerably more generous benefits provided. The sponsors and trustees of defined benefit funds are also concerned with both the ongoing funding of the benefits and the uncertainty of the regulatory environment.

We believe that the superannuation environment should be benefit neutral, but although it can be easily argued that defined benefit funds are a superior form of retirement saving, the minimum requirements of the superannuation guarantee operate as a disincentive to those employer sponsors who previously were prepared to carry the extra costs of defined benefit funds.

We would hope that the government might review its policy in relation to defined benefit funds so that those that do remain can continue to be viable.

Recommendation: Review the current position of Defined Benefit Funds to ensure that employers are encouraged to maintain their existing funds through a benefit neutral environment.

9. Cost of compliance

The current regulation environment which involves three different regulators, APRA, ASIC and the ATO - and which clearly involves some duplication of roles - and is a major contributor to compliance costs. In addition, the requirement for regulated funds to hold two licenses, with two reporting regimes, considerably increases the costs at fund level.

It is our opinion that there should be one regulator for all funds including SMFs, with the ATO maintaining a role confined only to the taxation aspects of the superannuation system. This would result in a far less complicated and less costly compliance environment.

It would also be less confusing for the membership in circumstances where there is a complaint in respect of a fund. At present there is a lot of confusion as to which regulator a disgruntled member can approach for a solution.

We take the position that it is time to consider the establishment of a single regulator to oversee the superannuation system taking on the role of ASIC, APRA and the ATO in relation to all funds including SMFs. We also believe that a single license should be developed for the purposes of superannuation funds, for as with other duplications in the system, the two-license requirement increases compliance costs. It can be expected that rationalizing the system in this manner should reduce costs and the administrative burden on the funds, and also the cost to government, without reducing the proper prudential supervision of the system It is important to always remember that the higher the costs to funds of regulation and licensing, the less benefit there is for members.

Recommendation: That a single regulator and a single licensing system be established for the superannuation system.

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

We would refer to the discussion above in Reference 9 on the cost of compliance and our belief that a rationalization of the regulatory agencies and a single license would result in a noticeable cost saving to both funds and the government.

The only additional comment we would offer In relation to the appropriateness of the funding arrangements, apart from the suggested rationalization, is that funding of the system should where possible be proportional to the extent of the assets of the fund and its risk profile.

Recommendation: That the level of funding of prudential regulation provided by funds through licensing and other similar fees should be proportional to the extent of the assets of the fund and its risk profile.

11. The costs of promotional advertising

There is an argument that non-public offer funds are breaching the sole purpose rules in running advertising campaigns. We do not necessarily believe that this is the case but this question needs to be clarified so that there is certainty.

The move to choice of fund has caused an environmental shift creating a need to advertise for funds that previously had no need to do so. In addition, the nexus between employment and superannuation is declining as superannuation membership is no longer confined to employees, or necessarily related to work. In a market system it would be unreasonable to permit some funds to advertise but prevent others from doing so.

We would also argue that the pursuit of new members does add significant advantages for members through the economies of scale in terms of administration and management costs. On the other hand, although we would not like to see excessive amounts of member's funds being dedicated to advertising campaigns, we do not see a need to add extra complexity to the regulatory system by, for example, requiring the development of an advertising policy or disclosure of advertising budgets.

Recommendation: That the rules of superannuation be amended to remove any doubt about the validity of advertising.

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

The major difference between funds that describe themselves as "not for profit" and "all profits go to members" and retail funds is that in the case of the "not for profits" all earnings remaining after all expenses

have been paid are returned to members, where in the case of retail funds some earnings pass on to the shareholders in the institution that owns the fund.

This is a significant difference and there must be a way for consumers to be able to distinguish retail funds from other funds in way that makes the differences clear.

Nonetheless there are recognisable problems where “not for profit” funds contract to organizations in which individuals associated with the fund hold an interest. In addition, in many circumstances these contracts may not be subject to the discipline of the market. This creates a risk that profit in “non-profit” funds is being distributed downstream, with profits paid indirectly to individuals associated with a fund, who hold interests in the service provider. This is in many ways similar to profits being paid to shareholders of retail funds.

We recognize that when contracts involve associates, as long as the associate has not been directly involved in the decision to award the contract and the contract is on commercial terms there can be few objections. But we still believe there is a need for total transparency where all contractual dealings are concerned because it is in the best interests of the members of the fund to know if anyone associated with the fund is personally benefiting through these arrangements.

We take the position that the best approach to this is to require disclosure of the interests held both directly and indirectly by individuals associated with a fund in any contractual arrangement made with a service provider. We see a process similar to that used to identify the beneficial owners of assets used by the ATO for Controlled Foreign Companies and Foreign Investment Funds being applied in the case of superannuation to identify those whose interests should be disclosed.

This disclosure should include timely notice to the regulator, and also inclusion in the annual report of the relevant fund.

Recommendation: That there should be greater transparency around the process of contracting with outsourced providers, through disclosure of the names of entities and/or individuals with associations with a fund who directly or indirectly have an interest in the other contracting entity.

13. Benchmarking Australia against international practice and experience

The distinct nature of the Australian superannuation system makes it difficult to benchmark against international practice and experience. Non-government retirement funding is relatively new in Europe, and where it is established it is seen as an addition to the existing government sponsored pension systems.

Similarly in the UK, private pensions are voluntary and the recent government white paper on retirement funding recommended a default government pension fund for those who did not chose a private pension voluntarily. This bears little resemblance to the Australian system, as the UK system will remain essentially voluntary, as individuals can to opt out of the proposed default fund and rely on the government age pension alone.

Even the Swiss pension system which bears the closest resemblance to that of Australia has significantly different features, including automatic rollover of member accounts on change of employer and a guaranteed annual return funded by the government in times of economic downturn.

We believe that benchmarking against international standards should be done where there is sufficient similarity to justify the costs involved. Otherwise it would appear that the cost of such benchmarking, whoever it may fall on – the funds or government – is not justified, as it would not provide a truly accurate measure.

Recommendation: That benchmarking against international standards is only done when there is sufficient similarity to justify the expense of the benchmarking.

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

As we have already pointed out, for most Australians superannuation is their most substantial asset after their home. It is a compulsory long-term investment specifically directed at producing retirement income and is therefore unlike any other financial product.

The loss of a person's superannuation can have a catastrophic impact on an individual's life in retirement, justifying a much greater degree of protection of superannuation products than that afforded to other investment products.

Currently, compensation for losses is awarded at the discretion of the responsible minister and can be made only in cases of theft and fraud. This is financed by a levy on all superannuation funds Unfortunately theft and fraud are not the only causes of losses of superannuation savings. Losses can also occur when:

- A business becomes insolvent with outstanding SG debts; or
- The trustees have been negligent in managing the investments of a fund.

In addition to a small number of superannuation theft and fraud cases there has been continued reporting of serious losses to workers where failed businesses have not met their Superannuation Guarantee commitments.

We believe that the issue of trustee negligence can be adequately dealt with by compulsory trustee insurance but that compensation should also be extended to the situation where an employer becomes insolvent with outstanding superannuation guarantee contributions.

Theft and fraud in superannuation is very rare. Until a commercial trustee company, Commercial Nominees Australia Ltd (CNAL), collapsed in 2001 the compensation provisions had not been activated. The collapse of CNAL left hundreds of fund members with little or no retirement income. The CNAL collapse was followed by the smaller collapse of Australian Independent Superannuation (AISF) in Western Australia. In both cases the Minister decided that affected fund members would be compensated for only 90% of their losses.

Although the "moral hazard" argument has been raised to justify not providing 100% compensation we believe that this is not a valid argument in the context of a mandated superannuation system – one where individuals have no choice but to contribute – we therefore believe that the current system should provide 100% compensation where funds are lost through theft or fraud and that the Ministers discretion to decide the level of compensation should be removed.

Apart from the increase to 100% compensation we believe the current arrangement in relation to theft and fraud should be continued but where the loss is a result of the insolvency of an employer. the preferable place for compensation for unpaid SG contributions is the current employer insolvency arrangements under the Government Employee Entitlement and Redundancy Scheme ("GEERS").

We also believe that protection should be extended to post-retirement products as well as pre-retirement superannuation. If it is devastating for an individual to lose superannuation savings during their working life it is even more devastating to lose benefits after retirement.

Recommendations:

- **Losses due to theft and fraud be fully compensated and not be at the discretion of the Minister.**
- **Losses of Superannuation Guarantee amounts caused by insolvency should be compensated through the GEERS.**
- **Losses caused by negligence should be compensated through insurance.**
- **That the compensation regime be extended to cover post-retirement products.**

15. Other Matters

15.1 Clearinghouses

We wish to bring to the attention of the Inquiry issues that have arisen in relation to superannuation clearinghouses and timely payment of superannuation contributions.

As the Committee will be aware, with the introduction of the choice regime, a number of superannuation clearing houses were developed to assist employers who were required to make contributions to multiple funds on behalf of their employees.

The role of the superannuation clearinghouse is to receive contributions from the employer and then ensure that contributions are paid on to the appropriate funds, as chosen by the employee. This relieves the employer of the burden of issuing multiple cheques to the various funds selected by their employees under the choice regime. The use of a clearing house is intended to not only reduce the burden of the choice regime on the employer but also to make mistakes in payments less likely, and consequently reduce the possibility of penalties resulting from incorrect or late payments.

Unfortunately, the clearinghouses are facing some problems because of failures beyond their control. These failures are arising despite practices designed to ensure timely payment of contributions to superannuation funds.

The superannuation guarantee regime requires that payment of contributions must reach the "destination" fund within 28 days from the end of the quarter.

There are a number of reasons why contributions may not reach the member's account and consequently not be vested by the due date which are not necessarily in the control of the employer or the clearinghouse acting on their behalf. There are three specific situations that we would like to bring to your attention. They are:

- A "destination" fund failing to recognise a cheque or not presenting a cheque before the closing date for contributions (even though the cheque is received prior to the quarterly SG deadline) ;
- The incorrect completion of a form by an employee, for example the provision of an incorrect ABN for the fund; or
- The employee failing to provide necessary data to the "destination" fund in advance of the cheque arriving at the fund.

Where any of the above occurs the employer is heavily penalised for late payment of superannuation obligations under the Superannuation Guarantee (Administration Act) 1992, despite the fact that the employer has made all attempts to pay on time. These problems are exacerbated where employers are in an industry where there is a mobile work force and employees are required to complete a new form for each new job.

The penalties can include:

- The requirement to make a second payment of the contribution;
- Penalty interest;
- Administrative fees; and
- A deferral of tax deductibility;

and can create a serious financial burden for a business.

We are particularly concerned about the failure of "destination" funds to present cheques that have arrived prior to the closing date

Where an employee has failed to provide correct information or to notify the destination fund that they wish to become a member we believe that it is unfair to penalize the employer and request that some leniency be allowed for employers placed in this position.

Recommendation: That concession regarding penalties should be introduced where the contributions do not become vested by the due date due to factors outside the control of the employer or the clearinghouse.

15.2 Research Houses

We have become concerned with the ranking of the performance of superannuation funds by research houses. The present situation requires a fund wishing to be ranked to pay the research house to carry out the assessment of the fund's performance.

We believe that this system is open to serious conflicts of interest and there is a risk that these conflicts could lead to results that misrepresent the relative merits of different fund performances.
It is very important that any data that reaches the public that will be used to influence the choice of a fund by a consumer must be totally uncorrupted. We believe that the only way that independent assessment can be assured is having an independent body carry out the assessment of all funds.

We would recommend that the Government appoint the Government Actuary to carry out an independent assessment of the performance of funds to be published annually and that all funds pay a levy to cover the costs of the annual survey. This would not only guarantee an independent ranking of funds it would also be a lower cost to funds and ultimately to members.

Recommendation: That the Government Actuary is appointed to research and rank superannuation funds on an annual basis and that this activity to be funded by a levy on the funds.

15.3 Grandfathering

The concept of grandfathering when new rules are introduced has created an unwieldy system, which has created unacceptable costs to all members of funds who are now paying for the benefits of a few.

We believe that it is now time to seriously review those grandfathered arrangements that remain and estimate the costs involved in removing them in order to simplify the system and make it fair for those who do not benefit from the concessions this provides to few. In saying this, we acknowledge that the Government has made some significant steps towards simplification in the superannuation initiatives in the 2006 Federal Budget, but there are still opportunities to simplify the system further.

Recommendation: That the current grandfathering arrangements be reviewed with a view to removing them in order to simplify the superannuation system.

Yours sincerely

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