SUBMISSION ON BEHALF OF HOST-PLUS PTY LIMITED INTO THE INQUIRY INTO THE STRUCTURE AND OPERATION OF THE SUPERANNUATION INDUSTRY

Host-Plus Pty Limited is the trustee of the HOST**PLUS** Superannuation Fund (HOST**PLUS**) which is the industry superannuation fund for the hospitality, tourism, recreation and sporting industries. As at the date of this submission, HOST**PLUS** currently has approximately 726,000 members nationwide and approximately $5 billion in assets under management. HOST**PLUS** has 9 directors, 3 appointed by its employer sponsor organisation, 3 appointed by its member sponsor organisation and 3 independent directors.

Host-Plus Pty Limited (**Trustee**) wishes to make a submission to the Parliamentary Joint Committee on Corporations and Financial Services into the inquiry into the structure and operation of the superannuation industry.

Terms of reference

We understand that the committee will inquiry into the structure and operation of the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**) and the superannuation industry to ensure that it provides an efficient, effective and safe regulatory structure for the management of superannuation funds, with particular reference to:

1. Whether uniform capital requirements should apply to trustees.

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

3. The relevance of the Australian Prudential Regulation Authority standards.

4. The role of advice in superannuation.

5. The meaning of member investment choice.

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

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

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

9. Cost of compliance.

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

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

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

13. Benchmarking Australia against international practice and experience.

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

15. Any other relevant matters.

This Submission

The trustee proposes to comment on numbers 1, 2, 4, 11 and 12 in this submission.

Contact details:

Please contact David Elia, Chief Executive Officer on (03) 8636 7702 if you require any further information on this submission or wish to discuss the same.

Executive Summary

- The Trustee does not believe that all trustees need uniform capital requirements;
- The Trustee does not believe that all trustees should be public companies. No extra protections are bestowed on the members;
- The Trustee believes that advice is an essential component in superannuation and has introduced a new method of payment for members to access advice about their superannuation benefits;
- The Trustee supports competition in the Australian marketplace. The Trustee therefore believes that in its circumstances that advertising is a legitimate expense of the fund, and therefore to its members;
- The concept of “Not for profit” and “all profit goes to members” are legitimate concepts that should be continued to be supported by Government as they are in the interests of superannuation members and legitimate competitors to retail superannuation funds.

Initial Statement

HOST**PLUS**, whilst being an industry fund is a major stakeholder in the superannuation industry. As stated in the introduction to this submission, the Fund has 726,000 members around Australia, $5bn in assets under management and is serious about providing appropriately costed superannuation benefits, so members can live well in their retirement and help take the burden off the Federal Government in the form of social security benefits.

HOST**PLUS** is proud of its governance structure. It has 9 directors, 3 appointed by an employer association, 3 by an employee association and 3 independent directors appointed jointly by the initial sponsoring associations. Its directors comprise some of the highest profile people in the industry and in business in general. The Board is therefore not controlled by any one of the sponsoring associations.

HOST**PLUS** is proud to be able to provide low cost, high performing investments and quality superannuation benefits to many different types of employee throughout Australia from company executives to waiters and cleaners. HOST**PLUS** wishes to remain competitive in the Australian marketplace as it believes it is making a positive contribution to not only to Australian society but to business in the form of capital invested in the marketplace.

Trustee submission

1. Whether uniform capital requirements should apply to trustees

1.1 After analysing the current system the Trustee believes that no further protections would be bestowed on the members if all trustees were required to have uniform capital requirements.

1.2 The Trustee has in place a Risk Management Strategy and a Risk Management Plan which identifies, ranks and details the way risks are handled and mitigated in the Fund. It also has access to trustee indemnity insurance that should be able to cover most losses caused by the Trustee's negligence.

1.3 Currently the SIS Act and RSE licence conditions require that only public offer funds have certain capital requirements (see section 29DA(2) or (4) of the SIS Act. This is clearly set out in APRA Superannuation Guidance Note SGN150.1 "*Capital Requirements – Net Tangible Assets*" dated July 2004. The Guidance Note also provides an outline as to how APRA will assess whether an applicant for an RSE licence or an RSE licensee meets the net tangible asset requirements.

1.4 The Trustee is keeping its comments directed solely to industry superannuation funds and therefore will not be commenting upon corporate and other non-public offer superannuation funds.

1.5 The distinction between industry funds and public offer funds is as follows:

(1) There are those public offer funds which are purely retail funds which must hold $5 million in net tangible assets and/or an approved guarantee. Retail public offer funds are usually the subsidiaries of large financial institutions such as life companies which have access to enormous shareholder capital and accordingly can easily meet the $5 million NTA requirements. Many holding companies are listed on the Australian Stock Exchange.

(2) Industry funds are in a different position in that they do not have access to shareholder capital as usually the trustee has limited share capital, for example $2-$10, which, has been initially paid up by sponsoring associations, these being equal numbers of employer associations and member associations. These associations have the right under the Company's constitution to appoint equal numbers of directors so as to satisfy the equal representation rules set out in section 89 of the SIS Act. In order to satisfy the current capital requirements of being a public offer fund, those industry funds that have elected to become public offer funds usually do so by way of appointing a custodian to hold all of the fund assets, such custodian having an NTA requirement of $5 million and now due to recent APRA requirements, the Fund can also have $100,000 in an administration reserve account[1] which will serve to have the same effect as the $5 million NTA requirement.

(3) Industry funds' use of a custodian is an effective risk management tool as it reduces the exposure to fraud by any of the Fund's officers or directors as there are stringent transfer protocols and reporting mechanisms which must be followed. External custody stops fraudulent behaviour and self-dealing by directors and exposure to fund manager insolvency. The built in reporting mechanisms are designed to monitor, report and stop unusual transactions. The custodian always retains legal title to the assets on behalf of the Trustee.

[1] APRA FAQ 9.1, APRA can impose a higher amount in the RSE Licence conditions.

The Trustee always has recourse to the custodian's professional indemnity insurance cover.

(4) Industry Fund Trustees themselves do not have access to $5 million in capital and accordingly, if it is proposed to harmonise the requirements between industry and retail funds, this would significantly affect the ability of industry funds to:

(i) raise the required capital; and

(ii) effectively compete on a cost effective basis.

(5) In order for industry funds to raise the capital, their trustees would have to seek capital contributions from their shareholders which in the Trustee's case are the Australian Hotels Association (employer association) and the Liquor, Hospitality and Miscellaneous Workers Union (member association).

A $2.5 million contribution from either organisation would create financial hardship to these organisations whose core business are not running superannuation funds. The Trustee argues that they should not be required to do so in the first place for the reasons listed below.

(6) HOST**PLUS** was established in 1988 as the industry fund for the Hospitality and Tourism Industries under the relevant Federal and State awards. This has continued to date. The Fund has operated on a "*not for profit basis*" therefore neither of these sponsoring organisations have ever been paid a dividend or any return of capital to them. The sponsors believe that supporting the Trustee and HOST**PLUS** is in the best interests of their members, employers, employees and the Hospitality, Tourism, Recreation and Sporting Industries as a whole. It is the Trustee's submission that if there was a requirement that the Sponsoring Associations put up this capital then they may want or even require a return (eg dividend or capital return) and the Fund could no longer operate on a "*not for profit basis*", to the detriment of the HOST**PLUS** members, in the form of lower retirement savings over time.

(7) The other option would be for the Trustee to raise the money from the members themselves by way of some sort of levy which in our view is untenable and would defeat the purpose of being a "*not for profit fund*", increase costs to members and also defeat the purpose of having capital adequacy standards and requirements in the first place.

(8) Superannuation funds also outsource their risk. Most funds outsource their administration. Administration is a major business risk to Trustees, but usually there are well drafted indemnity clauses in the Administration Agreements that serve to protect the Trustee and the fund members from any errors on the part of the administrator. There is also access to external professional indemnity insurance by the administrator.

(9) Superannuation funds are already one of the most highly regulated financial products. There are preservation rules affecting how contributions are to be treated and when benefits can be paid and to whom. The core purpose of a fund is to provide retirement benefits[2]. There are numerous other restrictions such as prohibitions on lending, borrowing, in-house assets, liens and charges and acquiring assets from members, accordingly, in our opinion further prescription is not required.

[2] Section 62 of the SIS Act, "*Sole Purpose Test*".

(10) Accordingly, in our opinion extra capital adequacy standards are not required as there would be no additional benefit to Fund members.

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

2.1 The Trustee does not believe that all trustees need to be public companies. Again no extra benefits or protections are afforded to fund members except that they will bear extra compliance costs. This position has also been accepted and stated by the Australian Prudential Regulation Authority in its submission to this Inquiry.

2.2 The Trustee believes that the status quo provides adequate protection for superannuation fund members and having trustees change their current corporate structure adds no real benefit.

2.3 A review of the *Corporations Act 2001* reveals that the only section that would have any bearing on supporting the proposal is section 195 whereby a director of a public company may not be present in a director's meeting if they have a material personal interest. Otherwise all current statutory requirements as to directors duties apply to directors of proprietary companies.

2.4 As most trustees, if required to be public companies, would be unlisted public companies, the same access to capital requirements and issues remain. The Trustee sees no value in changing the status quo.

2.5 Particularly we address the following issues which differentiate public companies from proprietary companies:

(1) **Requirement that a public company hold an Annual General Meeting (section 250N of *Corporations Act*)**

In our view this requirement is unnecessary for trustees of superannuation funds unless the company conducts business in its corporate capacity, as trustees of superannuation funds who only act in a trustee capacity conduct operations on behalf of superannuation fund members and not for the benefit of shareholders of the trustee. This is particularly the case for industry funds which act on a "not-for-profit" basis.

Many trustee companies are essentially a corporate shell that hold no assets in their own capacity and in such circumstances it is unnecessary to hold an Annual General Meeting as shareholders derive no benefit from the trustee's activities (apart from very minor directors fees).

(2) **Convenience of proprietary company member resolutions as opposed to public company requirement of a formal meeting of members (section 249A)**

Shareholders of proprietary companies can conveniently pass member resolutions in place of holding a formal meeting of members by signing a statement indicating they are in favour of the motion. Given that most trustee companies have only a nominal number of shareholders the requirement of holding a formal meeting of members to pass member resolutions is inconvenient and unnecessary.

(3) **The requirement to prepare annual financial reports and directors reports**

The requirement of public companies to prepare annual financial reports and director's reports (section 292(1)) is futile where a trustee is acting purely in the capacity as trustee of a superannuation fund as the company itself will likely hold no assets in its own capacity.

The Corporations Act already requires trustees to prepare and send to members annual reports in relation to the operations of the superannuation funds for which they are trustee as well as annual member benefit statements indicating how individual member's benefits are performing in the fund.

Accordingly, in our view, the present exclusion of the requirement of small proprietary companies to prepare financial and directors reports should be maintained for trustees.

(4) **Requirement to appoint an auditor**

The requirement of public companies to appoint an auditor (section 327A(1)) is unnecessary for trustees who only act as trustees for superannuation funds as in such situation the company in its corporate capacity will have no assets or liabilities or profit or loss to be audited.

It is observed that superannuation funds are already required to be audited regardless of whether the trustee is a proprietary company or public company.

(5) **Member approval for related party benefits**

The requirements of Chapter 2E of the Corporations Act in relation to related party transactions for public companies is unnecessary and futile for trustees of superannuation funds.

Section 109 of the SIS Act already requires that trustees and investment managers of superannuation funds invest on an "arms length" basis which means transactions are already exempt from the related party benefit rules under the Corporations Act because "arms length" transactions are specifically excluded from those rules (section 210 of the Corporations Act).

The application of these laws would therefore largely duplicate regulation already provided for in the SIS Act.

Additionally, in our view, if accountability for related party transactions is required of trustees it should be to members of the fund rather than shareholders of the trustee company.

Accordingly the related party transaction laws applicable to public companies are largely irrelevant and impractical for superannuation fund trustees.

(6) **Public company requirements may be inconsistent with SIS Act requirements**

The requirement that a public company have at least three directors may conceivably be inconsistent with the equal representation rules under the SIS Act for some funds which may wish to have only one employer and one member representative on a trustee board.

Additionally, the fact that section 203D of the *Corporations Act* 2001 gives shareholders of public companies the right to remove directors by an ordinary resolution of shareholders (regardless of what the company's constitution states) when taken together with section 107(2)(a)(ii) of the SIS Act, which requires that generally member representative directors of a fund trustee can only be removed by the same procedure by which they were appointed, causes concerns for present procedures used to elect member representative directors of trustees.

Specifically if superannuation fund trustees are required to be public companies section 203D will effectively require that the appointment of member representatives be by ordinary resolution of all of the shareholders of the company which is contrary to many existing trustee constitutions which allow a quota of member representative directors to be nominated by employee associations ,other member representative bodies or elected by the fund members and not by the shareholders as a whole.

(7) **Requirement for public company office to be open to public**

The requirement that a public company generally have its registered office open to the public between the hours of 10 – 12 pm and 2 – 4 pm each business day is an unnecessary inconvenience for superannuation funds which are not public offer funds such as many corporate funds. As such funds have a restricted membership only generally associated with the principal employer of the fund they should not be required to be open to the public.

4. The role of advice in superannuation

The Trustee believes that advice is an essential component in superannuation.

Advice can take many forms, whether educational information provided by the Trustee to its members in fund publications (general advice) and websites or specific personal advice provided by financial advisers to their clients. Education is very important but is no substitute to appropriately tailored personal financial advice.

Financial Advice

The Trustee is in favour of appropriate advice. Proper financial advice should be paid for. Whilst recognising that there is a danger that most advice is not truly independent, due to product providers owning most of the financial planning companies, the Trustee supports a fee for service method of charging for financial advice rather than the charging of commissions on superannuation contributions or member's benefits. The payment of commissions by product providers creates a fundamental conflict of interest that even if disclosed, will in most circumstances, not be in the best interests of the member seeking the advice.

HOST**PLUS is** pleased to announce that from 1 January 2007, members will have the ability to choose an additional method of payment for financial planning advice for superannuation only. Members will be allowed to deduct a set amount from a member's account in order to pay for that advice. General Advice

The current definition of general advice is a disincentive to trustees of superannuation funds who wish to provide members with educational material concerning their investment.

HOST**PLUS** supports the submission by the Industry Funds Forum that consideration should be given to narrowing the scope of general advice in order to avoid the

licensing and disclosure requirements for general advice applying to educational activities conducted by Trustees of superannuation funds for the benefit of their members. In many instances educational aspects of fund publications have been deemed to be personal advice and have needed to be removed before publication. Therefore the Trustee submits that onerous conditions in the Corporations Act should be confined to personal advice. An exemption to the general advice provisions should be allowed for general educational activities provided by superannuation funds in order for members to understand their benefits.

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

11.1 The Trustee is in favour of competition in the Australian marketplace. The Trustee therefore believes that in its circumstances that advertising is a legitimate cost to the fund and therefore to its members.

11.2 It is clear that the legal position of the sole purpose test set out in section 62 of the SIS Act is that advertising in any media is a legitimate expense of the fund. It is simply another matter of the operation and administration of the fund for the trustee to manage. Accordingly a trustee should appropriately manage advertising, allocate appropriate funding whilst still acting in the best interests of members.

11.3 In relation to the broader industry, the Trustee believes that advertising is an essential component of competition which is a fundamental cornerstone of the current government policy. HOST**PLUS** should be able to compete in the open marketplace on equal footing with other superannuation providers such as retail funds. The only way an industry fund like HOST**PLUS** can do this is to utilise fund assets (as previously described in the capital adequacy section of this submission). It is a legitimate business expense.

11.4 Removal of the right of an industry fund like HOST**PLUS** to advertise or to use fund assets to advertise would in our opinion be a breach of Part IV of the *Trade Practices Act* 1975 and a restraint of trade and lessening of competition. HOST**PLUS** does not have a distribution network of financial planners like the large life offices who will recommend their products, and it can only rely on advertising for distribution of its products. Traditional protections such as the Award system are not as relevant or useful to the fund after the advent of the Choice of Fund legislation. The advent of the Portability provisions in the SIS Regulations are another factor that justifies the Trustee to advertise in order to retain existing members and if possible attract new members.

11.5 Retention of members means stabilisation of costs and growth over time of funds under management. Scale is important as it gives the trustee the buying power to reduce costs over the long term to members by way of lower investment management costs and lower administration costs. Lower costs means increased retirement savings for members and less reliance on any aged pension and social security facilities. Loss of members will lead to higher costs for members. Having a large membership base and $5bn in funds under management places HOST**PLUS** in an enviable position to compete with large retail providers such as AMP, MLC and AXA for example in order to retain current membership and grow scale.

11.6 In summary advertising serves 4 purposes:

(1) Firstly, it helps retain members and employers which allows the retention (and building) of scale which in turn reduces member costs.

(2) Secondly, it is a mechanism to attract new employers sponsors to choose the fund as its default fund under the Choice of Fund legislation.

(3) Thirdly, reduced member cost means increased retirement savings which is a cornerstone of the Federal Government Superannuation policy. This leads to lower demands on the social security system.

(4) Fourthly, advertising also allows for member education about existing benefits, new benefits and saving for retirement.

11.7 The Inquiry must also be careful in how it defines advertising. For example, advertising could extend to mandated disclosure documents in the Corporations Act such as Product Disclosure Statements, Annual Reports and significant event reporting on benefit changes to members etc. The Trustee is concerned that this should not be affected as it is already highly regulated.

11.8 The last point to note is that retail funds already make members indirectly fund "advertising" expenditure in the form of higher fees.

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

12.1 The Trustee supports the concept of "*not for profit*" and "*all profits go to members*". That is the ethos and intent of the Trustee and the way it treats its members.

12.2 In the Trustee's opinion, "*not for profit*" and "*all profits go to members*" are simple concepts that the Government should support. As stated above the Choice of Fund legislation has produced a new environment in which all superannuation fund trustee's have to compete in the marketplace. The terms relate not only to industry funds that historically grew out of the Award system, but to corporate superannuation funds and public sector superannuation funds.

12.3 What does "not for profit" mean? In the Trustee's opinion, it means that a trustee can make a profit from the service that it provides, but it is how the trustee applies that profit that matters. For example, it means that any surplus of funds retained (after applicable operational expenses) from fees deducted from member accounts are retained by the trustee and reinvested into further services for members or to enhance the fund net earning investment return allocated to members. Thus all profits go to members. In the case of industry funds, as explained previously, there is no dividend that is paid to the Trustee's shareholders. Dividends under the Corporations Act can only be paid from profits. The "profits" from operations are retained/reinvested in the fund for the benefit of the members. Therefore the trustees of industry, separate stand alone corporate funds (as distinct from corporate sub-plans in a retail master trust) and industry funds can easily state that they are "not for profit" or "all profits go to members" without being in breach of the Corporations Act provisions that regulate advertising and misleading and deceptive conduct.

12.4 As members now have adequate choice and unlimited access to licensed financial planners they can choose whatever type of fund they wish to belong to without restriction. This is the essence of competition. Accordingly, the Trustee does not support any attempt to restrict or deny the "not for profit" fund sector in the Australian market and supports its retention.