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22 September 2006

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

E-mail: corporations.joint@aph.gov.au

Dear Mr Sullivan

Inquiry into the structure and operation of the superannuation industry

CPA Australia welcomes the opportunity to make a submission to the committee's inquiry in to the structure and operation of the superannuation industry.

CPA Australia is the pre-eminent body representing the diverse interests of more than 108,000 finance, accounting and business advisory professionals working in the public sector, public practice, industry and commerce, academe and the not-for-profit sector.

We are a long time advocate of superannuation as a retirement savings vehicle. We have worked closely with the Government and its departments, through consultation, providing comment on policy and legislative change, sitting on industry committees and appearing before various parliamentary inquiries.

CPA Australia believes the superannuation industry is appropriately structured and significant regulatory controls have been put in place to ensure superannuation fund members' benefits are adequately safeguarded. The most important thing the superannuation industry needs in the near future is stability. There has been significant change within the industry in recent times, particularly on the regulatory front with the introduction of APRA trustee licensing. We believe the current regulatory regime needs time to settle in before it can be determined if it is operating effectively and appropriately. Only then can any gaps or shortcomings be identified and appropriate action be considered.

Our responses to the specific terms of reference are contained in the attached submission. Should you have any queries or require further information please contact CPA Australia's superannuation policy adviser, Michael Davison, on 02 6267 8552 or by email: michael.davison@cpaaustralia.com.au.

Yours sincerely

Paul Meiklejohn FCPA
President
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CPA Australia

Submission to the inquiry into the structure and operation of the superannuation industry

General Comment

Historically, superannuation had only limited coverage of the Australian workforce and was mainly provided by more benevolent employers as an employee benefit used to attract and retain staff. Typically, these employers were government or larger national/international employers.

Benefits were often defined benefit or a mix of defined retirement benefits and accumulation based resignation benefits that only vested in the employee after a certain period of employment. Older funds tended to provide pension entitlements in preference to lump sums. Typically, it was the employer who bore the investment and longevity risks of the entitlements provided for the employees.

However, in recent decades the role of superannuation as an employee benefit has diminished somewhat as a result of:

- the introduction of compulsory contributions, which has removed superannuation as a differentiating employee benefit. That is, superannuation has moved from being an employee benefit to being a right. As a result, many employers who may have been making higher voluntary contributions have reduced them down to the level required by the superannuation guarantee. Voluntary employee contributions have also reduced as the requirement to match employer contributions for a higher benefit has also been removed;

- changing work patterns have seen a reduction in long term employment with a single employer in favour of more mobility and short term employment and casualisation of the workforce;

- legislative change has largely severed the nexus between employment and super. For example, the removal of the contribution “work tests” now means anyone under the age of 65 can contribute to superannuation; and

- changes to vesting rules, whereby all contributions are now required to fully vest in the employee, means superannuation can no longer be used as “golden handcuffs” to encourage employee loyalty.

Combined with the diminishment of super as an employee benefit, to the point where it is now just seen as another cost of business, employers providing a superannuation fund for their employees have also had to contend with:

- increasing compliance costs, both financially and in terms of resources, due to increased regulation, increased disclosure requirements, Financial Services Reform licensing, and now APRA licensing;

- the cost of providing broader features such as investment choice and providing members with greater access to fund information through call centres and the internet, etc;

- employees being given greater responsibility for their own retirement savings through things like investment choice and legislated fund choice; and

- a proliferation of service providers for administration, investment management, trustee services, etc.

As a result, employers have largely divested themselves of the responsibility for their employees' super and have either outsourced part or all of the operation of their superannuation funds or, more likely, they have outsourced the provision of their employees' superannuation to commercially operated superannuation funds.

There has also been considerable consolidation within the industry, particularly with the introduction of APRA licensing, and the thousands of funds that did exist (excluding SMSFs) now number in the hundreds.

Compulsory superannuation has also impacted on the superannuation landscape in other ways.

The introduction of award contributions (with the involvement of the trade union movement) and subsequently the superannuation guarantee saw the establishment and subsequent growth of industry funds. Originally linked to particular occupations or industries, industry funds provided access to superannuation for the first time for many workers, although many are now open to the general public.

Commercial operators – the banks, life offices, fund managers, and associated service providers – have significantly increased their presence in the superannuation market as they have seen the opportunities presented by the continuing flow of contributions into the system due to compulsory superannuation.

There has also been significant growth in self managed superannuation funds (SMSFs). Once the domain of the self-employed, SMSFs are now utilised across the board as legislative change have made them more accessible. With often greater flexibility and control, they can form an integral part of an individual's overall personal financial arrangements when used appropriately.

These shifts in the superannuation landscape have seen the emergence of three distinct streams of superannuation funds:

- commercially operated "retail funds";

- funds primarily operating for the benefit of members – corporate, public sector and industry funds; and

- funds being used as part of an individual's personal arrangements – SMSFs.

These funds all have their own distinct roles within the superannuation landscape. The integrity of the super industry is maintained by the competition and diversity that exists between the different types of funds.

There has also been a greater focus on individuals taking responsibility for their own retirement savings. This has been reflected in the greater flexibility individuals now have to contribute to and access their superannuation, the greater flexibility within superannuation offerings such as broader investment choice, and through the introduction of fund choice.

All in all, there has been a shift in responsibility for superannuation, both from employer to employee and employer to "commercial" superannuation provider.

This recognition of this shift has led to considerable changes in the way the superannuation industry is regulated. There has been a tightening of regulation under the SIS Act, the introduction of the Financial Services Reform Act with its impact on disclosure and licensing requirements, and the recent introduction of APRA licensing for fund trustees.

There is now a much greater focus on trustee responsibility. Firstly with the approved trustee requirements and now APRA licensing. The professionalism of (APRA regulated) trustees has increased as the focus on responsibility has increased. This is born out by the requirements that need to be met, eg "fit and proper", to become an RSE licensee.

The superannuation industry is now highly regulated and there are many safeguards in place to protect members' benefits. Many of the regulatory changes have been quite recent and quite significant, particularly the requirements of AFS licensing and APRA licensing, and trustees have gone to considerable lengths to comply with these requirements.

The superannuation industry has been in a state of constant change for over 20 years. While there is always room for fine tuning, we believe the industry is appropriately structured and stability is now needed, free from legislative and regulatory change, if people are going to embrace the system. Before any more change can be considered, the current regime must first be given time to settle in order to determine if it is working appropriately.

Following are CPA Australia's specific responses to the inquiry's terms of reference.

1. Whether uniform capital requirements should apply to trustees

The need for uniform capital requirements was considered as part of the safety in superannuation review in 2001 and deemed unnecessary. We do not believe the environment has changed in any way to alter that conclusion.

Superannuation funds have different capital backing needs depending on their nature. For instance, SMSF trustees operate superannuation funds for their own benefit at their own expense so there is no need for separate capital backing. Similar trustees of stand-alone corporate funds would have the backing of the employer sponsor to cover any contingent costs of the fund.

For funds to establish capital backing (except for retail funds), the money would have to come from current members' entitlements, effectively providing backing for future members. This would create equity issues between generations of fund members and would be a significant barrier to entry for new trustees and superannuation funds.

The important issues is that trustees have appropriate and adequate resources available to them to ensure they are able to fully meet their obligations in relation to operating their fund/s and meet all contingencies. This has been reflected in the Superannuation Safety Act and is one of APRA's key requirements for a trustee to obtain a Regulated Superannuation Entity (RSE) license. In addition, public offer funds must also meet capital adequacy requirements.

We believe the recently introduced APRA licensing requirements need time to settle in before the adequacy of the capital requirements can be reassessed.

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

We do not believe there would be any benefit gained by requiring all trustees to be public companies. There is no need for a trustee to be a company to properly discharge its fiduciary responsibilities. The prudential rules apply equal to individual trustees and directors of corporate trustees and provide adequate safeguards for fund members. Such a requirement would merely be adding an additional layer of complexity and unnecessary expense.

3. The relevance of the APRA standards

APRA's standards and circulars play an important role in clarifying APRA's interpretation of the law and how they will regulate it. They are a necessary part of the regulatory environment and are used by a variety of regulators, including the ATO, ASIC and State revenue authorities. Therefore it is vital their currency is maintained and they are updated in a timely manner.

The main issue is the level of duplication and the apparent lack of co-ordination or consistent interpretation between the regulators. Both APRA and the ATO regulate superannuation funds under the SIS Act. Yet their interpretations can vary widely, for example, the definition of fund rules. Similarly, trustees had to provide similar information to ASIC and APRA to apply for their AFS and RSE licenses, yet there was very little information shared between the regulators.

There is also a perception that APRA is getting overly involved in determining the "correctness" of trustee decisions instead of focussing on the process trustees should follow in reaching those decisions.

4. The role of advice in superannuation

It is essential to recognise the difference between product advice and structural and strategic advice in the area of superannuation. The impact of the current definitions is that it is impossible to provide straightforward information regarding the operation of superannuation outside the systems that have been set up for selling financial products. This means that the cost structures and client protection relevant for formal product advice are imposed on what would otherwise be explanation of the different regulations that have been established by Government to encourage savings.

While there are various sources of information available to ensure Australians are well informed to prepare for retirement, it is essential that informed, professional advisers are used at every opportunity to make that advice accessible and affordable.

In providing appropriate and necessary consumer protection with respect to financial products, current interpretation of Legislation means that strategic advice relevant to the structure of superannuation is confused with recommendations as to entering or exiting a particular superannuation fund.

What constitutes buying or selling an interest in a super product is not just when you first make a contribution to a super fund or when you withdraw or roll over a super fund. Any recommendation to place money into super is treated as a separate investment into the specific product the client uses while redirection of future contributions to a different fund is seen as exiting the old fund even when the assets already there are not moved.

For this reason, any recommendations relating to superannuation flows require full financial services licensing. This also means that a full Statement of Advice is required. We wait with anticipation to see the outcome of recommendations to the FSRA following the recent consultation.

While a reasonable person would expect that advice relating to the amounts of contributions and the tax treatment of them, as soon as there is any level of opinion as to what is the best tax option, it is treated as buying a super product.

To illustrate the distinction, answering the question "What happens if I salary sacrifice $4000 into super" is factual information/tax advice and outside FSR while "How much should I salary sacrifice into super?" is caught under FSR. The response currently required is that the adviser must be licensed and must provide a full Statement of Advice.

The areas where ASIC has reported concerns in superannuation have been where a change of fund disadvantaged the clients. ASIC generally found the strategic advice in the Shadow Shopper survey to be helpful.

Accountants are often asked simple questions on salary sacrifice and spouse superannuation and are forced to provide highly qualified responses and send the clients to a financial planner. Such referral should only be necessary for situations where there is a need for product selection or a full financial plan.

There needs to be a separation of product advice from the strategic advice that relates to superannuation. The current treatment of anything with an opinion relating to superannuation is confusing to the general public. When a recognised accountant within a public practice can clearly explain the tax treatment of a superannuation contribution, the public expects them to be able to provide a professional opinion as to the relative merits of undeducted contributions, salary sacrifice contributions and spouse contributions. Such advice relates to the superannuation environment rather than to the selection of a particular fund.

Superannuation structures

CPA Australia believes that providing advice on superannuation structures should not be regulated under FSR.

In the June 2004 report of the Parliamentary Joint Committee inquiry into Reg 7.1.29 under the Corporations Regulations 2001, the committee endorsed our position. Findings include:

- the committee considers that the application of FSR licensing regime to accountants who do not provide investment advice on specific, branded financial products and merely engage in traditional accounting activities is unnecessary.

- the committee believes that Reg.7.1.29 should be amended, at the very least, to provide accountants with a licensing exemption for recommendations made about superannuation fund structures to their clients.

- licensees who do not have professional accounting qualifications and tax agent status may not give the quality of advice that would be expected on superannuation fund matters.

Regulation 7.1.29A was announced by the Treasurer in February 2004, allowing accountants to give advice to clients on whether they should acquire or dispose of an interest in a Self Managed Superannuation Fund. We believe this exemption should be extended to allow discussion of superannuation structures more generally so that advisers can discuss the different types of superannuation funds in general terms.

We believe the government must permit recognised accountants to give advice on super structures other than restricting the advice to SMSFs.

We are concerned at the message this sends to clients – that they can talk to their accountants about whether a SMSF is appropriate for their needs and circumstances, but cannot deal with them if the SMSF structure is not appropriate in terms of considering alternative super structures. Clients seeking guidance from their accountants cannot currently access this guidance from their accountants when it comes to determining an appropriate superannuation structure.

Advice on structures per se is integral to the work done by an accountant. Precluding the ability to advise on superannuation structures other than SMSFs may see a proliferation of SMSFs which have been demanded by clients because of their inability to deal with their accountant and the clients' reluctance to engage another professional to give such advice.

Being able to advise on a suitable structure for a client is only one step further on and a logical progression from providing factual information. It does not involve the recommendation of particular funds and therefore should be able to be given without the need for licensing.

5&6. Member investment choice

With the increasing expectation for individuals to take responsibility for their own retirement savings they need the flexibility to do so. This means having a variety of suitable choices available to meet their needs.

It is now common for most superannuation funds to offer a range of investment options to members, often ranging from diversified options that suit particular risk profiles, e.g. growth or balanced, through to single sector options, e.g. Australian shares, which allow members to construct their own 'portfolio' based on their individual needs.

It is important that trustees offer a balanced range of investment options that will suit the needs of all fund members. This would range from appropriate 'default' options for members who do not make an active choice or decide the default option is most appropriate for them, through to single sector options which can be utilised by more experienced members or those receiving independent investment advice.

Trustees should also ensure members have access to appropriate information and advice so they have the knowledge to make informed decisions. There should also be scope for members to gain this knowledge from independent sources.

The difficulty for trustees at the moment is APRA's interpretation of the SIS Act whereby trustees are required to formulate their investment strategy/s based on the fund's circumstances as a whole. Trustees are not permitted to allow an individual member's investment choice if that choice would not be suitable for the fund as a whole. Trustees cannot take into account an individual's needs, for example if they have other investments outside of superannuation, or if they have received independent investment advice.

CPA Australia believes that provided a fund trustee provides a balanced range of investment options, and particularly default options, that will suit the majority of members, then the trustee should be able to offer real investment choice to those members who want it.

7. The reasons for the growth in SMSFs

Part of the Government's broader retirement savings policy is to give individuals greater choice and flexibility and more responsibility for their own retirement savings. SMSFs are an integral part of this policy and the superannuation industry. SMSFs are not for everybody but where used appropriately, SMSFs give individuals much greater flexibility and control and allow them to manage their superannuation as part of their overall personal financial arrangements.

Research conducted on behalf of CPA Australia in 2004 found that the main reason the majority of SMSF 'owners' (i.e. members) had a SMSF was to have control over their investments and future and greater flexibility. Other influences included tax advantages, expected better returns and lower costs and fees. There have also been suggestions that the rate of establishment of new SMSFs is a reflection of the performance of other superannuation providers. ATO statistics show the rate of establishment increased following the poor investment performance experienced by many funds in the early 2000's but has now dropped off again after recent high investment returns.

With much greater awareness (largely through the Tax Office's education campaign and publications) of the appropriateness of SMSFs and the responsibilities that go with them, we

believe the rate of growth will level out as people realise SMSFs may not suit their needs and they choose other more appropriate structures.

While the regulation of SMSFs is conducted by the ATO as opposed to APRA, they are just as highly regulated as larger funds, with the fund auditor playing a very important role in ensuring trustees comply with the superannuation legislation. This has been further enhanced by the requirement for auditors to report all legislative breaches to the ATO through the auditor contravention report (ACR) process.

8. The demise of defined benefit funds and increased use of accumulation funds

While the number of defined benefit funds has dropped considerably, there are still a number of funds operating. The reduction in funds has come about as employers have divested themselves of their responsibility for their employees' superannuation (as discussed in our opening comments), increased regulation has added to the complexity of defined benefit funds to the point they are no longer viable, and employers have increasingly moved to reduce the risks associated with beign exposed to longevity and investment risk.

9. Cost of compliance

The cost of compliance for superannuation funds has increased considerably due to greater SIS regulation, increased disclosure, AFS licensing and APRA licensing. The superannuation industry has experienced considerable consolidation but any cost savings from increased economies of scale have been eroded by increased compliance costs. For example, the cost of obtaining an APRA licence was considerable with reported costs for some larger funds being as high as $100,000. These costs will ultimately be passed onto the members.

With these increases in compliance costs, the question still remains of has there been any real increase in the security of members' entitlements. Regulation and the cost of complying with it must be balanced with the benefit it is actually providing.

10. Funding arrangements for prudential regulation

Is the industry getting value for money? With the reduction in the number of funds being regulated and APRA having access to better information from the industry, it is a reasonable proposition that the cost of APRA regulation should be falling.

With respect to SMSFs, the lower regulatory fee, even with the recently announced increase, is reasonable considering a large part of the regulatory monitoring is not carried out by the regulator but by the fund auditor, which is an additional cost borne by the trustees.

It is also arguable that the regulatory fee for small APRA regulated funds (SAFs), which is currently $500, is too high and may be a barrier to more people using SAFs when compared with the SMSF fee. Given much of the APRA regulation is of the RSE licensee and not the individual SAFs, maybe some of the fee should actually be levied on the trustee.

11. Promotional advertising

While we accept a trustee's right to advertise their superannuation, we question the cost of doing so and the ultimate benefit to members. Whether costs come directly from the fund or are paid by the commercial operator of the fund, or associated party, they are ultimately paid for from the fund members' balances. Therefore, the trustee must be able to justify to members what the benefit to them is. That is, they should really be disclosing what the costs and benefits are.

12. The meaning of ”not for profit”

Genuine “not for profit” funds operate on the basis that the trustee, or shareholders in the trustee company, do not profit from the operation of the fund. While it can be argued that the service providers in the supply chain (where the fund outsources some or all functions) will be taking a profit, provided they are unrelated to the trustee it really is just part of the cost of the running the fund. As the trustee should be acting in the best interests of the members, they would have determined that it is most beneficial to members, either through cost or capabilities, to outsource rather than do it in house.

Provided “not for profit” funds are operating for the benefit of the members there shouldn’t be a problem.

On the other hand, trustees of ‘retail funds’ generally operate a fund in order to provide a return to their sponsor/owner or shareholders. When pricing their superannuation offering they will build in the cost of running the fund - administration, investment management, compliance etc, whether done internally or externally - into the fees charged and then add their desired profit margin on top. It is arguable that the “for profit” funds will have a greater negative impact on retirement savings than the “not for profit” funds.

13. International benchmarking

Given APRA licensing has only just be implemented and with the upcoming superannuation simplification changes, we believe all of these changes should first be bedded down and the industry allowed to stabilise before any international comparisons can be considered.

If any international comparisons were to be considered, we should be comparing the adequacy of retirement savings that will be provided by the Australian system compared to other countries.

14. Level of compensation

The level of compensation has been reviewed extensively in the past and found to be adequate. We are comfortable with the current level.

15. Other relevant matters

Superannuation reform

While the proposed changes in the Government’s superannuation simplification package will go a long way to simplifying the superannuation system and improving retirement savings, we believe there is still more to be done to ensure the majority of Australians have adequate retirement savings to maintain their standard of living in retirement. Areas that should be addressed include:

- removing the “10% rule” for tax deductibility of personal contributions so that everyone has equal flexibility in determining the tax treatment of their contributions;
- providing greater incentives or concessions for people who experience broken work patterns;
- encouraging additional voluntary savings through an “opt-out” compulsory contribution scheme; and
- the development of a retirement savings target.

Family superannuation funds

One of the major dilemmas with SMSFs and SAFs is that they are restricted to having four or less members. This creates a problem for larger, or extended, families who may want to manage a single superannuation fund for their entire family unit. This has become increasingly difficult with the introduction of APRA licensing as the cost of obtaining a license effectively prohibits the establishment of such a fund.

Given the central premise of a SMSF is that all members of the fund are trustees and hence collectively responsible for their own interests in the fund, we propose that the number of members allowed for a SMSF be increased to cater for such situations provided all the members are related parties. While it is difficult to determine what the number of members should be, ten would seem a reasonable number.