SUBMISSION TO INQUIRY INTO THE STRUCTURE AND OPERATION OF THE SUPERANNUATION INDUSTRY

Superpartners Pty Ltd

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Introduction

Superpartners Pty Ltd provides administration services to a number of large industry superannuation funds totalling over five million member accounts. As Australia's largest superannuation administrator, Superpartners services on behalf of its client funds 453,000 registered employers, has $53 billion in funds under administration and employs 1,270 staff in eight offices nationwide.

We welcome the opportunity to make this submission to the Parliamentary Joint Committee on Corporations and Financial Services "Inquiry into the Structure and Operation of the Superannuation Industry".

Executive summary

1. Whether uniform capital requirements should apply to trustees**:** Uniform capital requirements should not apply to trustees. Non-public offer funds do not have the capital resources to meet a uniform standard. The solution is a wider adequacy of resources standard, introduced by the APRA licensing regime.

2. Whether all trustees should be required to be public companies: Trustees should not be required to be public companies. Public company status and shareholder pressure would weaken the accountability of trustees to fund members. Superannuation funds have more rigorous risk controls and disclosure than public companies.

3. The relevance of APRA Standards: APRA standards act as valuable guidance to the industry. For the purposes of control of APRA powers and consistency with subordinate legislation, APRA standards need statutory recognition and can be issued as operating standards under existing powers.

4. The role of advice in superannuation: The present requirement for funds and administrators to have an ASIC general advice licence is unnecessary. Funds should be regulated by APRA alone (insofar as they do not give personal advice). In the field of personal advice, there should be closer regulatory monitoring of commission-based advice by financial planners, as fund-choice advice tends to ignore non-commission paying industry funds.

5. The meaning of member investment choice: covered in 6.

6. The responsibility of the trustee in a member investment choice situation: The trustee is responsible for ensuring the member has adequate information to make an informed choice as well as implementing and monitoring the fund's investment strategies. However, the trustee cannot be responsible for the individual investment choice selection.

7. The reasons for the growth in self-managed superannuation funds: No comment.

8. The demise of the defined benefit fund and the use of accumulation funds as the industry standard fund: The decline of the defined benefit fund is a consequence of the coverage of mandatory employer-contributed superannuation guarantee, the high cost of defined benefit administration and potential unfunded liabilities. This decline represents a transfer of risk from employer (funding risk) to employee (return risk).

9. Cost of compliance: With intense political interest in superannuation, the cost of compliance is certain to grow. However, a single regulator and single licence (as discussed in 15C) and a simplified superannuation system (as discussed in 15B) will contain the cost of compliance.

10. The appropriateness of funding arrangements for prudential regulation: No comment.

11. Whether promotional advertising should be a cost to a fund and, therefore, to its members: Promotional advertising is a legitimate fund expense as membership retention and growth are a key element of a fund's business plan, particularly in a choice of fund environment. Advertising for these purposes is in the interests of members as it achieves economies of scale and enhances product comparability and competition. Advertising costs are included in fee disclosure to members.

12. The meaning of the concept "not for profit" and "all profits go to members": This means that a fund operates for the benefit of its members and not external shareholders. Apart from recovering operating costs, all profits are returned to the fund and are not disbursed by dividends to shareholders. Industry funds should be entitled to make comparisons with retail funds which generally have inbuilt profit margins in trustee fees, commission structures or costs associated with related investment and financial planning entities.

13. Benchmarking Australia against international practice and experience: International benchmarking is appropriate but must take account of local conditions.

14. Level of compensation in the event of theft, fraud and employer insolvency: No comment.

15. Any other relevant matters: Four additional matters are raised:

A Avoiding disclosure of commissions: Certain industry practices avoid member disclosure of commission paid to advisers. These are:
(a) commission paid for procurement of members;
(b) trail commission misdescribed as ongoing service commission; and
(c) commission paid by an interposed entity.
There should be greater legislative clarity and regulatory monitoring of commission disclosure.

B Complexity of the superannuation system: The superannuation system is unduly complex and is focussed on revenue protection to prevent abuse of tax concessions. The government's policy of simplification is supported. Nevertheless, real simplification can only occur on the removal of taxation of benefits and contributions. The preservation rules can also be simplified. There should be a simplified Product Disclosure Statement with prescribed wording in laypersons' language.

C Competition for administrators: Competitive neutrality should operate for public sector administration. Regulatory guidance is needed to clarify the circumstances when a fund should go to tender and when to test a competitive offer.

D Merger of Regulators: There is an unwieldy overlap in ASIC and APRA functions. Merging the two Regulators will achieve a single licensing system. Both entities share a fundamental purpose of protecting the public and promoting confidence in the Australian financial system.

1 Whether uniform capital requirements should apply to trustees

Currently, capital requirements apply to public offer funds only.

In particular, public offer funds[1] are required to have the following capital adequacy requirements:

(a) $5 million minimum net tangible assets;

(b) an entitlement to the benefit of an approved guarantee of a minimum $5 million;

(c) a combination of the above, totalling $5 million; or

(d) the trustee complies with relevant APRA requirements[2].

The purpose of the capital adequacy requirements is:

- to provide some financial resources as a security against risk;
- to demonstrate the trustee's commitment to its superannuation business; and
- to serve as an incentive to the trustee to manage the fund appropriately.[3]

According to the policy of the present legislation, the foundation of capital adequacy lies in the public offer nature of a fund which represents a break from the trustee-employer sponsor nexus.

By contrast, non-public offer employer-sponsor funds are unlikely to have any capital or financial resources in their own right. The funding of expenses incurred by a non-public offer fund is generally sourced from fund revenues or assets in accordance with the fund's governing rules or, in some cases, by the employer-sponsor[4]. Non-public offer funds are free of shareholder interests and are subject to mandatory equal representation on the trustee board[5]. The long term commitment to the fund's superannuation business is sustained by the industry employer sponsors establishing the fund for the benefit of their employees. To date, all fund failures have occurred in the public offer market.

A uniform capital adequacy requirement would prevent the legitimate contribution to the diversity of the superannuation market offered by non-public offer funds (including lower cost structures) that is currently available in the flexible capital adequacy requirements. The flexibility of the current capital adequacy requirements

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[1] A public offer fund means a fund that has at least one member who is not a standard employer sponsored member (ie. a member for whom an employer makes contributions under a direct arrangement with the fund trustee): s.18(1) of Superannuation Industry (Supervision) Act 1993 ("SIS Act").

[2] s.29DA of SIS Act; Reg. 3A.04 of Superannuation Industry (Supervision) Regulations ("SIS Regs.")

[3] APRA Superannuation Guidance Note (SGN) 150.1:"*Capital requirements –net tangible assets*" (July 2004); para.4

[4] APRA SGN 140.1:"*Adequacy of Resources*" (July 2004) para.14

[5] Non-public offer funds must have equal numbers of member representatives and employer representatives on the Board of its corporate trustee (or as individual trustees in the case of unincorporated trustees): s.93 of SIS Act.

means that capital adequacy can be tailored to the nature of the superannuation offering.

The Superannuation Working Group (2002) considered[6] and rejected the extension of uniform capital requirements to all funds. Instead, it recommended that capital adequacy should be determined by APRA in a flexible amount (rather than a prescriptive minimum or maximum) as part of a wider standard regulating a fund's adequacy of resources[7].

It must be understood that the recent APRA licensing regime[8] has now established a broader adequacy of resources standard for all funds. This standard operates independently of the capital adequacy rules[9] and is intended to ensure that funds have adequate resources (particularly financial, technical and human resources) to undertake the fund's activities. This standard requires the fund to demonstrate:

- adequate resources to ensure ongoing solvency; and
- adequate liquidity to support its business operations.

APRA's assessment of a fund's compliance with the resources standard will take into account the range of factors contemplated by the Superannuation Working Group; such as:

- availability of alternative working capital (in the case of non-public offer funds);
- material business activities performed in-house (with a greater risk margin expected for in-house activities);
- support provided by an employer sponsor; and
- scope and level of indemnity insurance cover[10].

In assessing compliance with the standard, APRA will consider the nature, scale and complexity of the particular fund's operations. Thus, an assessment which caters for different superannuation offerings is integral to maintaining a diverse marketplace offering consumers alternative superannuation products, with different product features, fee structures and distribution channels.

In addition, the APRA licensing regime imposes risk management standards for funds, which includes a detailed, auditable Risk Management Strategy covering the trustee operations and a broader Risk Management Plan covering the fund operations[11]. The existence of these wide ranging risk management and resources standards obviates the need for uniform capital requirements for all funds. The real issue is the adequacy of the fund's operational resources and its risk management controls.

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[6] *Report of the Superannuation Working Group on Options for Improving the Safety of Superannuation* 28 March 2002: p.46: Option 2

[7] ibid; Recommendation 16: pp.5-6

[8] Part 2A (ss.29A-29QB) of SIS Act; Part 3A (Regs.3A.01-3A.06) of SIS Regs; Superannuation Guidance Notes issued by APRA.

[9] APRA SGN "*Adequacy of Resources*" (supra); para.12

[10] ibid; para 16

[11] This is explained in greater detail in APRA SGN 120.1 "*Risk Management*" (July 2004)

While public offer funds are commonly associated with retail for profit funds, recent experience has seen traditional industry funds enter the public offer market to broaden their membership base. These funds are subject to the same capital requirements as retail funds. Otherwise, risk protection for non-public offer funds can be appropriately managed by the operational resources requirements and risk management controls in the new licensing regime.

2 Whether all trustees should be required to be public companies

It is assumed that the purpose of this term of reference is to suggest that funds should be aligned with the level of disclosure or members' rights applying to a public company or a managed investment scheme; such as:

- mandatory annual general meetings[12];
- members' rights to requisition a general meeting[13];
- voting powers to remove trustees or fund managers[14];
- public access to the fund's annual returns[15].

Likewise, it is assumed that this term of reference suggests that the public company status of a fund may enhance its public accountability and transparency.

We submit that a uniform conversion of trustees to public company status is not in the public interest. The reasons are as follows:

1. the trustee's statutory covenants (extending personally to the directors of a corporate trustee), including the duty to exercise the same degree of care and skill as in dealing with the property of another person as if morally bound,[16] are inconsistent with taking account of the interests of the company and possibly, the public shareholders;

2. trustee directors are subjected to more risk-averse approach than public company directors; for instance:

    - a superannuation fund can only be maintained for the sole purpose of retirement and ancillary benefits[17];
    - the SIS Act does not recognise a business judgment rule[18];
    - trustee directors are required to balance risk with return[19], a situation inconsistent with a public company charter to maximise return.

3. the conversion of industry-based standard employer sponsored funds to public company status without the consent of employer sponsors overlooks

[12] s.250N of Corporations Act 2001
[13] s.249D (*public company*); s.252B (*managed investment scheme*)
[14] s.203D (*removal of a public company director*); s.601FM (*removal of a responsible entity of a managed investment scheme*)
[15] under the public right of inspection and copying of documents lodged with ASIC (subject to prescribed exceptions): s.1274(2) of Corporations Act
[16] s. 52 of SIS Act
[17] s.62(1) of SIS Act
[18] s.180(2) of Corporations Act
[19] s.52(2)(f) of SIS Act

the industry specialised nature of the fund and the opportunity of member participation through the equal representation rules;

4. accountability of a fund is enhanced through the superannuation-specific annual disclosure requirements of fund information[20] and member account information[21] as well as member rights to request further information[22];

5. regulatory scrutiny of a fund is enhanced by superannuation-specific returns comprising detailed prudential and auditing information[23];

6. funds have a higher level of mandatory risk management controls than do public companies[24];

7. the allocation of voting rights and shareholdings will be difficult to translate to the fund membership base with wide variances in account balances;

8. trustees are required by legislation not be subject to a direction by any other person[25];

9. trustees' duties extend beyond the directors' duties of management of the fund to make decisions about granting death and disablement benefits to individual claimants[26] and, in the case of death benefits, tracing all eligible beneficiaries and weighing up competing claims, before deciding how to distribute the benefit, which is subject to the scrutiny of statutory review by the Superannuation Complaints Tribunal[27];

10. trustee executives are on a substantially lower level of remuneration than their public company counterparts with the result that increased remuneration costs will be passed on to fund members in a cost sensitive environment;

11. standard employer-sponsored non-public funds enjoy a relatively low cost base compared to retail public funds and should remain open to compete with retail funds in a choice of fund environment;

12. the conversion to public company status should consider any adverse tax treatment of fund earnings.

A requirement that all trustees be public companies could attract a higher exposure of risk by reason of shareholder expectations and distractions from the duty to act in the best interests of fund members. The trustee obligations in the SIS Act mean

[20] Regs.7.9.31-42 of Corporations Regulations

[21] see, for example, s.1017D of Corporations Act; Regs. 7.9.19-21 of Corporations Regulations (this is not exhaustive)

[22] s. 1017C; Corporations Reg.7.9.45

[23] see APRA Forms SRF 260.0; SRS 330.0; APRA Superannuation Circular no. iv.A.6 "*Responsibilities of the Approved Auditor*" (June 2005)

[24] Each Trustee must lodge with APRA a renewable and auditable Risk Management Strategy (ss.29H-HA of SIS Act) and each fund a Risk Management Plan (ss.29L(2)(e); 29P). The Risk Management Plan is available for member inspection: s.29PD(1). See APRA SGN 120.1 "*Risk Management*" (June 2004) paras. 7-12.

[25] s. 58(1) of SIS Act. Specified exemptions are set out in s. 58(2) and SIS Reg. 4.02, of which the most common is member investment choice (see Term of Reference 6).

[26] While death and disablement claims are usually assessed by an outsourced group life insurer, the courts have made it clear that a trustee cannot abrogate its duty of due consideration by reliance on the insurer.

[27] ss. 14, 14A, 24A of Superannuation (Resolution of Complaints) Act 1993

that directors or individual trustees of non-public offer funds must shed their representative character on appointment and must act solely in the best interests of the members, without regard to the interests of the employer or employee body that appointed them[28].

In conclusion, the current system of non-public offer trustees and public offer trustees should be retained. The conversion of all trustees to public company status weakens, rather than strengthens, accountability and transparency.

3 The relevance of APRA Standards

APRA Standards serve as useful guidance to the industry in clarifying regulatory requirements in accessible form. However, the prescriptive detail of the standards disguises the fact that the standards serve as de facto regulations.

The APRA Standards in the form of Superannuation Guidance Notes go further than the scope of the regulations they purport to interpret. For instance, the APRA Outsourcing Standard states an outsourcing agreement should provide that breach of confidentiality may result in penalties or termination of the agreement[29], in contrast with the Regulations which state that the agreement must provide for confidentiality[30]. Yet, the standards (rather than the Regulations which summarise the requirements in compendious form) effectively act as preconditions to obtaining an APRA licence.

Similarly, the standards disclaim they have no legal status or legal effect whatsoever[31]. Nevertheless, the content of the standards make it clear that compliance is expected in order for a licence application to succeed.

For the purposes of control of APRA powers and consistency with subordinate legislation, APRA standards need statutory recognition. The standards can be issued as operating standards[32] under existing powers. Hence, the standards can be regarded as a different process for exercising an existing power, rather than superimposing a new power[33].

4 The role of advice in superannuation

The focus of our submission questions the need for an ASIC general advice licence. Our submission also challenges the suitability of commission-based personal advice, particularly when switching funds.

There is always a place for advice in superannuation as members have questions about their investment or their fund. Advice about a superannuation product is a logical consequence of a fund issuing the product.

Advice in superannuation amounts to financial product advice for the purposes of the ASIC-regulated financial services regime. This regime draws a distinction between general advice and personal advice.

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[28] Sir Anthony Mason, "*Superannuation and Conflicts of Interest*" (paper delivered at Superannuation Lawyers Conference; Hobart, February 2005) pp.2.18-2.19,
[29] APRA SGN 130.1 "*Outsourcing*" (July 2004) para 20(f)
[30] SIS Reg. 4.16(4)(f)
[31] SGN 130,1 ; p.2; para. 2.
[32] s.31 of SIS Act
[33] Superannuation Working Group Report; p. 37; see also: N. Gullifer "*APRA Standards and Powers under Safety in Superannuation*" (Paper delivered at Superannuation Lawyers Conference; Hobart, February 2005)

Personal advice is advice that considers one or more of the recipient's objectives, financial situation and needs (or that a reasonable person might expect the adviser to have considered one or more of those matters[34]). Personal advice is usually financial planning advice.

General advice, on the other hand, means any advice that is not personal advice and amounts to a recommendation or opinion intended to influence the recipient in making a decision about a financial product[35]. The definition of general advice is extremely wide and can range from a fund promotional brochure to a verbal statement that a fund has a wide range of insurance options to choose from.

In practice, the fund's call centre is the usual starting point for a member query. In our experience, funds restrict their call centres (often conducted by an outsourced administrator) to giving general advice, while referring any matters involving financial planning advice to an authorised representative licensed to give personal advice. This is because call centres handle high volume member queries, most of which are account queries, and are therefore not equipped to engage a member in personal advice.

Furthermore, ASIC has imposed restrictions on call centres giving general advice. The only call centre staff able to give general advice are those staff who:

- have completed an accredited training course ("PS146");
- are under the direct supervision of a PS 146-trained person; or
- are confined to a script prepared by a PS 146-trained person[36].

This system of regulation is attractive in theory by recognising the dichotomy between general advice and more considered personal advice, requiring a higher level of accreditation and disclosure[37]. Notwithstanding, the question must be asked why superannuation funds that operate or outsource call centres giving routine advice on their own products should be regulated by an ASIC licence at all when they are already regulated by APRA.

In the present environment, the fact that a fund issues a superannuation product and explains its product to members is enough to attract the ASIC licensing regime[38] in addition to the APRA licensing regime. Likewise, administrators acting as agents of the fund must undergo ASIC licensing on the basis that they provide general advice to fund members (on behalf of their client fund).

The dual licensing system has added undue cost and complication to superannuation funds. Previous enquiries have noted the need to avoid unnecessary overlap and confusion[39]. The APRA regime and the ASIC regime overlap in the following key areas:

- risk management;

[34] s.766B(3) of Corporations Act.
[35] s.766B(4)
[36] ASIC Policy Statement 146 "*Licensing: Training of Financial Product Advisers*" (August 2005)
[37] personal advice requires the contemporaneous giving of a prescribed Statement of Advice: s.946A of Corporations Act.
[38] ss.911A; 766A of Corporations Act: an Australian Financial Services licence issued and monitored by ASIC, described in this submission as an "ASIC licence".
[39] Financial Sector Advisory Council "*Review of the Outcomes of the Financial System Inquiry*" (August 2003); p.10; Superannuation Working Group, *supra*; pp.24-25

- organisational competence;
- adequacy of resources;
- indemnity insurance;
- outsourcing[40].

Already, ASIC has relaxed the licensing rigor where funds provide advice about their own product. For instance, a product issuer is exempt from giving a Financial Services Guide where the issuer deals only with its own products[41].

More recently, ASIC has exempted product issuers from the licensing regime on condition that:

- the advice is not personal advice;
- the advice is confined to the issuer's particular product; and
- the issuer informs the recipient:
    - that the issuer is unlicensed;
    - that the recipient should consult the Product Disclosure Statement; and
    - the existence of any cooling off period[42].

The effect of this exemption is to put non-ASIC licensed funds in a more favourable position than ASIC-licensed funds (who only enjoy a more restricted exemption if the advice is not about a particular product and is not intended to influence the recipient)[43]. This means that funds may be better off to surrender their ASIC general advice licence and rely on the exemption available to unlicensed entities.

The dual licensing system can be sensibly removed by exempting funds from the ASIC licence where a fund confines itself to advice about its own product. It follows that a fund would continue to be restricted from giving personal advice without an ASIC licence. As a result, funds would be governed by a single licensing regime (except where a fund ventures into personal advice which should be appropriately licensed).

Typically, a fund's call centre (whether conducted by an administrator or in-house) handles a high proportion of routine calls from members, as well as routine calls from participating employers (such as allocation and payee details). In times other than mailing of member statements, the majority of member calls are (in order of volume):

- change of address;

[40] Compare "*ASIC Licensing Kit: Part 3*" version 7 (November 2005) with "*Licensing and registering a superannuation entity: licence application*" (July 2004). ASIC dispenses with a risk management proof from APRA regulated entities.
[41] s. 941C(2)
[42] Reg. 7.1.33H of Corporations Regulations
[43] Reg. 7.1.33G

- checking an account balance;
- checking a member number or member details;
- change of beneficiary;
- rollover request; and
- eligibility to claim a benefit.

In call centres, the overwhelming majority of calls are account maintenance queries. Giving general advice is more the exception than the rule. General advice is limited to the following cases:

- responding to questions about certain options available to a member; such as personal contributions, government co–contributions, salary sacrifice; in which case, the answers are restricted to general statements (consistent with the printed disclosures contained in the Product Disclosure Statement) with recommendations to seek personal advice;
- answering prospective member enquiries about the fund; and
- conducting outbound calls to exiting members drawing attention to fund features.

In turn, the service standards governing an administrator's conduct of the call centre include a minimum percentage of calls to be answered within a specified time frame and a minimum number of calls abandoned in the call waiting queue.

In these functions, the administrator is effectively performing an educative role in member information and financial literacy, reinforcing the disclosure in the Product Disclosure Statement, the periodic member statements and exit statements.

The duality of the ASIC/APRA regulation fails to grasp that a superannuation fund cannot effectively issue a product to its members without engaging in incidental general advice. The involvement of an ASIC licence otherwise applying to all species of general financial advice is inappropriate and does not serve the public interest.

Likewise, the removal of ASIC licensing should apply to outsourced administrators of the fund. As ASIC licensees, administrators that do not qualify as related companies of the trustee are subject to a cumbersome requirement to give a Financial Services Guide[44]. Similarly, administrators conducting call centres commonly enrol their staff in PS 146-accredited training due to the uncertainty of the alternative of "direct supervision" by a PS 146 trained person. Administrators are outsourced agents of the fund and should logically mirror the licence requirements of their principals.

An administrator's ASIC licence also authorises the administrator to deal in superannuation products by arranging for the issue of the product. This means the administrator, as agent for the trustee, issues the product designed by the trustee and in accordance with the trustee's fund membership conditions. This licence

[44] As it provides general advice:s.941A.

condition does not relate to consumer advice and can be appropriately regulated by APRA under the outsourcing standard[45].

The purpose of the outsourcing standard is to ensure the outsourced services are subject to due diligence, monitoring and APRA audit. The APRA outsourcing proof is more prescriptive than the ASIC outsourcing proof: the APRA outsourcing proof prescribes content requirements[46] while the ASIC outsourcing proof merely asks licence applicants to describe how the licensee proposes to select and monitor outsourced service providers[47].

Another consequence of the ASIC licensing regime is that an administrator must appoint and retain ASIC-approved responsible officers, as well as its client fund having its separate responsible officers. It makes no sense to apply responsible officer rules to an administrator performing agency functions in respect of a product designed by its principal.

The end point is that superannuation funds and their administrators do not need an ASIC general advice licence nor an ASIC product licence. General advice, as opposed to personal advice, is, in essence, promotion and education.

Once licensing is removed for funds giving general advice, market conduct can still be regulated and enforced. The market discipline of funds for inappropriate general advice (eg. misleading advertising) is achieved through an enforceable undertaking given to ASIC. An enforceable undertaking does not require an ASIC licence but, ordinarily, can be accepted by ASIC in any matter in which it has a statutory function or power [48].

Otherwise, the sanction of licence cancellation or suspension is appropriate for non-APRA regulated fringe operators or rogue advisers giving personal advice. These licence sanctions have no practical application to funds and administrators that operate within the APRA regulatory framework.

A separate issue arises with the quality of superannuation advice given by personal advice licensees (usually financial planners) which are distinct entities from superannuation funds. In recent ASIC survey findings, a commission-based remuneration structure for personal advice licensees was shown to have a high degree of correlation with inappropriate advice, particularly when switching funds[49].

Industry funds do not generally pay commissions to personal advice licensees which results in consumers not being advised about the option of moving to an industry fund. The consequence is that personal superannuation advice is not given on the basis of the product that is most suitable for the client's needs[50].

ASIC has conceded that it "made no secret" that the commission model has meant many advisers did not advise their clients of industry funds[51]. The experience in the

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[45] SIS Reg.4.16(2); APRA SGN 130.1 "*Outsourcing"* (July 2004)
[46] APRA SGN 130.1 "*Outsourcing*" paras.19-22
[47] ASIC B3 Proof :Outsourcing Statement "*AFS Licensing Kit Part 3: Preparing your additional proofs: an ASIC Guide*" (November 2005); p.12
[48] s.93AA of Australian Securities and Investments Commission Act 2001; ASIC Practice Note 69 "*Enforceable Undertakings*" (April 1999)
[49] ASIC media release 06/104 "*Survey finds quality of advice on super still needs improvement"* (6 April 2006)
[50] "*Statutory Oversight of the Australian Securities and Investments Commission*" Parliamentary Joint Committee on Corporations and Financial Services (August 2006) para.2.37
[51] ibid; para.2.33

United Kingdom with pension fund switching carries a salutary warning of the dangers of commission-driven advice. The potential influence of a commission in advising consumers about switching presents industry funds with a structural competitive disadvantage with retail funds.

What is needed is more rigorous enforcement of the personal advice legislation. The existing regime requires the Statement of Advice to specify the loss of benefits from the old fund and any significant consequences for the client in making the switch[52]. The adviser must also make reasonable inquiries and conduct an investigation of the subject matter of the advice[53]. However, the ASIC survey results point to failures in these areas.

Regulatory guidance on personal advice in switching funds should recommend that the Statement of Advice specify the funds the adviser considered and why the funds were not recommended to clarify the transparency and scope of the advice given[54].

We submit that greater regulatory surveillance and control of commission-remunerated advice is needed both for consumer protection and competitive neutrality.

5 The meaning of member investment choice

This term of reference overlaps with Term of Reference 6 and will be considered as part of that section.

6 Responsibility of the trustee in a member investment choice situation

While the trustee has responsibility to act in the best interests of the members and to set the fund's investment strategy, there is controversy whether the trustee is responsible for assessing the most appropriate strategy for each member.

Trustees of funds are required to give effect to an investment strategy that has regard to all the circumstances of the fund, including the investment risk as well as the return from investments, having regard to fund objectives and expected cash flow requirements[55]. Member investment choice[56] is now widely offered for accumulation funds and recent experience has seen a significant expansion in the number and types of choices available to members.

The meaning of investment choice is that the member is offered the opportunity of choosing which investment option or combination of options that suits their needs, subject to the trustee's obligation to implement the fund's investment strategy. The investment option is, in effect, a choice of investment strategies, rather than a choice of investments, with each strategy complying with the investment strategy as directed by the SIS Act[57]. The exercise of choice assists the fund to review the risk profile of members in setting the investment strategies.

In default of a member choice, the fund must invest the member's account in a balanced default option in accordance with the default option's investment

[52] s.947D(2) of Corporations Act
[53] s.945A(1)
[54] ASIC already requires the adviser's Statement of Advice to set out the reasoning which led to the advice: PS 175 "*Licensing: Financial product advisers-Conduct and disclosure*" (Nov 2005); para 126)
[55] s. 52(2)(f) of SIS Act; SIS Reg.4.09(2)
[56] authorised by s.52(4)(b) of SIS Act: SIS Reg.4.02(1)
[57] s. 52(2)(f)

strategy[58]. In practice, the overwhelming majority of fund members do not exercise investment choice.

In some cases, the investment options available to members are pre-mixed by the fund, with the fund selecting the asset classes for inclusion, together with the proportion to be invested, while offering the member the opportunity to design their own investment portfolio using their range of asset class options[59]. More recently, funds have given members the opportunity to invest in a combination of listed stocks.

The fund's disclosure documentation draws the member's attention to the availability of financial planning advice to assist a member with their investment decision. This way, the fund reminds the member that their investment decision involves a review of their personal circumstances and objectives which a financial planner is qualified to advise and which the trustee is not.

APRA has advanced the view that the trustee should take more responsibility for the member's investment choice[60]. According to APRA, a trustee should also periodically advise members of the benefits of diversification and consider giving "health warnings" to members invested in narrow or risky options[61]. Yet, in some cases, a narrow or risky option may suit the member's needs having regard to the member's other investments (including non-superannuation) and investment objectives. Notwithstanding, a trustee is ill informed to make recommendations to individual members. In fact, this amounts to a personal advice which a trustee is not equipped or licensed to give.

APRA's view effectively imposes a duty to enquire into and monitor each member's investment choice. The imposition of this duty would make the duty of a trustee unworkable and is inconsistent with the duty of the trustee to act in the collective interests of the members.

The better view is that the responsibility of the trustee in a member investment choice situation should be limited to the statutory duties to act in the best interests of the collective members, to implement the fund's investment strategy in accordance with the SIS Act standards and to make proper disclosure[62]. Once the member has made an informed decision to exercise an investment choice, the trustee should be entitled to rely on the member's choice and not to inquire further.

The significance of member investment choice is that the member is responsible for their investment choice, while the trustee is responsible for offering an appropriate range of investment choice and implementing and monitoring the fund's investment strategies (including the selection of appropriate fund managers). The twin principles of proper disclosure and informed choice should regulate the exercise of choice in a member investment choice situation.

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[58] SIS Reg.4.02(3)
[59] such as Australian shares, international shares, property, diversified fixed interest and cash.
[60] APRA Superannuation Circular No.II.D.1 "*Managing Investments and Investment Choice*" (March 2006) paras. 43-45
[61] ibid, para.45
[62] The Product Disclosure Statement must inform the reader of any matter that might reasonably be expected to have a material influence on a decision to acquire the product (s.1013E) and any significant risks associated with the product (s.1013D(1)(c)). Further, the fund must disclose the investment strategy of each investment option, all information needed to understand the risk in the strategy and the range of directions available to the member (SIS Reg. 4.02(2)). An investment in an underlying product from another issuer (eg. listed stocks or a property trust) must have the same PDS disclosure as if made directly: s.1012A. See also: ASIC PS 184 "*Delivery of Product Disclosure for Investment Strategies*" (August 2006)

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

We make no comment on this particular term of reference.

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

The decline of the defined benefit fund is a consequence of the coverage of mandatory employer-contributed superannuation introduced by the superannuation guarantee legislation[63].

Traditionally, the defined benefit fund represented a bounty conferred by the employer sponsor to employees that joined the company's superannuation plan, whereby the employer sponsor bore the risk of ensuring the employees' end benefits were able to be met from the fund, as commonly found in large public companies or public sector agencies. However, the extension of superannuation by the guarantee legislation to small employers (who could not otherwise establish a defined benefit fund) accelerated the use of accumulation funds.

By reason of the complexity of the administration of defined benefit funds, the accumulation fund has become a more viable option. Defined benefit funds by their nature are labor-intensive, complex and more costly than accumulation funds. Defined benefit schemes face recurring funding pressures on employers. Public sector defined benefit schemes have ultimate recourse to government backing in times of unfunded deficits.

In recent years, many funds have closed their defined benefit scheme to new members. Regulators have stood aloof from the trend against defined benefit funds. Given that the employer sponsors face potentially huge liabilities in funding any deficit in a defined benefit scheme, it is unsurprising that accumulation funds have become the industry standard fund.

Accordingly, the demise of the defined benefit fund represents a transfer of risk from employer to employee. In a defined benefit fund, the employer bears the risk of commitment to a defined salary multiple, while in an accumulation fund, the member bears the risk of the return on the accumulation balance.

Public sector defined benefit funds represent a particularly significant drain on future public resources. For instance, the Budget for the State of Victoria reported that unfunded superannuation liabilities were an estimated $12.2 billion, nearly 14% of Gross State Product, and represented the state's largest liability[64]. It has been estimated (in 1994) that full funding of Federal Government superannuation schemes would require an injection of $60 billion in the Australian economy where total superannuation assets reached $170 billion and total assets in financial institututions reached $830 billion[65].

While defined benefit schemes provide more attractive retirement outcomes than accumulation accounts under superannuation guarantee, the social cost should be considered of saddling future generations with a potentially unsustainable burden of supporting previous generations. This trend is of particular concern in overseas

[63] Superannuation Guarantee Charge Act 1992; Superannuation Guarantee (Administration) Act 1992 and Regulations
[64] Budget Paper No 2 "*Strategy and Outlook 2004-5"* p. 49 (Victorian Government)
[65] D.B. Duval "*The Financing and Costing of Government Superannuation Schemes*" (Australian Government Actuary, 1994); p.7.

experience of widespread defined benefit schemes, such as United States and Europe.

National savings policies (reflected in superannuation guarantee) can reduce the drawings on the production of future generations[66]. An increase in superannuation guarantee should be considered as a means of enhancing national savings and developing a sustainable superannuation system.

9 Cost of compliance

The cost of compliance continues to grow with the relentless pace of legislative change. Regulation has been responsible for the growth of ancillary or service staff in the superannuation industry. In particular, increasing regulation has led to the establishment and growth, both within the funds and externally, of:

- legal and compliance services;
- risk management services; and
- marketing services.

By contrast, funds in former years customarily had legal, compliance and risk management functions conducted by the fund secretary.

More resources are spent in considering and debating regulatory compliance issues as well as engaging external legal advice and sign-offs. In particular, the breach reporting obligation to ASIC[67] has resulted in a widespread use of external law firms to advise whether or not to notify a compliance breach. The rising cost of compliance is reflected in the substantial increases in the APRA industry supervisory levy imposed on major superannuation funds. The Regulators' licensing obligations attract a major diversion of resources and expense in preparation of the licence proofs and supporting documents as well as periodic licence reviews and audits.

Likewise, the detailed disclosure obligations occupy increasing compliance and marketing review. An instructive example is the content requirement[68] for the Product Disclosure Statement (PDS) which has often resulted in documents of over 60 pages long. This outcome is not unexpected given that a checklist of all relevant PDS disclosure provisions reveals over 70 items. So far, all competing major superannuation funds have been unable to reduce the volume of the PDS and none have been able to introduce a short form PDS that effectively replaces the long form PDS. As a result, it must be questioned whether this serves the interests of the consumer or whether this has improved consumer education.

The new Financial Services licensing process by ASIC (2002-2003) closely followed by the APRA licensing process (2004-2005) contained large compliance costs, including legal advice and support services. There is no respite in sight with the May 2006 Budget changes and Anti Money Laundering proposals (projected for 2006-2007) attracting high compliance and administration costs. The Anti Money Laundering proposals pose a further layer of regulation with an additional regulator.

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[66] ibid, p.5.
[67] s. 912D of Corporations Act
[68] see, for instance, ss.1013B-1016F as well as Corporations Amendment Regulations 2005 (No 1): this list is not exhaustive

On current trends, with the intense political interest in superannuation, there is unlikely to be any abatement in the cost of compliance with all signs pointing to an inexorable growth in the cost of compliance. However, a single regulator and single licence (as discussed in 15C) and a simplified superannuation system (as discussed in 15B) will contain the cost of compliance.

10 The appropriateness of funding arrangements for prudential regulation

We make no comment on this particular term of reference.

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

Fund advertising serves the interests of members by attracting higher membership levels while retaining existing membership in accordance with the fund's objectives and business plan. Achieving increased membership levels mean economies of a scale for the end benefit of fund members.

In a highly competitive choice of fund environment, funds should be allowed to explain the benefits of their products to consumers in order to assist consumers to exercise their choice of fund. The policy underlying choice of funds is to encourage a fund member to actively exercise a choice in favor of a fund that best suits their needs and objectives taking into account matters such as fees, returns and insurance cover.

The purpose of the disclosure requirements in the financial services regime is to ensure consumer comparability[69]. Consumer comparability is best achieved in an open market. Fund advertising serves the long term public benefit of heightening awareness of retirement planning. In the wider market of financial services, superannuation funds are competing with managed funds for the public to invest their savings. The May 2006 Federal Budget announcements have made superannuation more attractive as an investment. The growing cost of social security requires the population to take greater individual responsibility for retirement planning.

The fund's use of advertising does not raise an issue of the sole purpose test[70]. The sole purpose test concerns the use of the fund's assets: that is, the fund's assets can only be maintained and used for the sole purpose of providing retirement benefits. Advertising costs are sourced from the fund's direct administration fees and indirect management costs, both of which are disclosed to prospective members in product disclosure statements and to current members in member periodic statements as required by the fee disclosure legislation[71].

According to the Regulator's Circular, there should be a reasonable, direct and transparent connection between a fund activity and the sole purpose[72]. Advertising costs amount to fund-sponsored marketing, education and member awareness and therefore form part of a fund's expected activities.

APRA's more recent advice to funds noted that expenditure on member retention is acceptable within the confines of the Circular. The advice described marketing

[69] ASIC Good Disclosure Principles: PS 168 "*Product Disclosure (and other disclosure obligations)*" paras. 44-76 (May 2005)
[70] s. 62(1) of SIS Act
[71] see Schedule 10 of Corporations Amendment Regulations 2005 (No 1)
[72] APRA Superannuation Circular no.III.A.4 "*The Sole Purpose Test*" (Feb. 2001); para.42

expenses primarily to attract new members as "difficult to justify"[73]. The advice did not expand on this statement. However, on reflection, marketing expenses can be justified as increasing fund membership and achieving economies of scale in accordance with the fund's business plan.

In our experience, larger funds have the capacity to generate greater economies of scale. For example, as our larger clients grew their member numbers by an average of 18% between 2002 and 2005, the administration fees levied against funds per chargeable member reduced by 2% in real terms. In the same period, we enhanced and substantially expanded the member services offering.

Growth in membership along with growth in funds under management and growth in investment return are key fund objectives. Without growth, a fund is likely to stagnate and be unable to maintain a competitive product in the superannuation market. As a matter of fund governance, a fund must develop a long-term strategic plan setting out how the fund can achieve growth, which is commonly achieved through marketing, acquisitions and product development[74]. This way, marketing the product is a legitimate fund activity.

The solution is that the cost of promotional advertising can be borne by the fund if it can be justified as a legitimate pursuit of the fund's objectives. The fund's objectives must conform to the sole purpose test. This way, each case is examined on its facts. If the advertising cannot be justified, a contravention is committed.

If advertising costs are not passed on to members, it is difficult to see how advertising could be funded by an industry-based fund, as opposed to a retail master trust. Any ban on passing on fund advertising costs to the membership base would have the result of conferring an immense competitive advantage on retail funds.

Any concern about advertising should extend to all promotional activity provided by sectors of the industry, including commissions paid for promoting and retaining superannuation products.

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

These concepts simply mean that:

- the particular fund operates for the benefit of its members and not external shareholders; and
- apart from recovering costs to operate the fund, all profits are returned to the fund and are not disbursed by way of dividends to shareholders.

The public is well aware that a superannuation fund incurs costs and that costs are passed on to the member. Marketing the "not for profit" concept educates the public that, after deduction of operating costs, returns are not distributed to non-member interests but are redirected to the fund for the benefit of members.

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[73] "*Letter to All Trustees of APRA Regulated Superannuation Funds*" from Ross Jones, Deputy chairman, APRA, dated 14 March 2005; p.1

[74] "*Best Practice Guide to successful business planning*" ASFA Best Practice Paper 16 (October 2002); pp.10,12; "*Superannuation Fund Governance: Understanding the framework; applying the principles"* ASFA Best Practice Paper 7 (August 2004); pp.13-14

In competing with retail funds, industry funds are entitled to make comparisons, on a fair and reasonable basis, with a retail fund which generally has inbuilt profit margins in:

- trustee fees;
- embedded commissions in contribution fees; and
- cost recovery in the retailer's investment arm and financial planning arm.

In effect, the public should be invited to consider that retail funds contain a fee for service structure for the end benefit of shareholders, rather than for fund members. ASIC has acknowledged, in publishing an enforceable undertaking in an advertising campaign comparing industry funds with retail funds, that the Regulator did not want to stop funds from explaining the benefit of their products to consumers, provided that funds do not go too far.[75]

The not for profit concept serves the interests of consumers and is consistent with the sole purpose test that funds can only be maintained to provide retirement and ancillary benefits.

In the interests of consumer protection, the application of fair trading legislation[76] and regulatory supervision of funds ensure that funds are deterred from making unfair or misleading comparisons with rival funds.

13 Benchmarking Australia against international practice and experience

International practice and experience are both valuable to the industry. Already, Australia is following international practice in various sectors of the regulatory system. For instance, the indirect cost ratio method for determining disclosure of indirect fees is based on the total expense ratio model recommended by the International Organisation of Securities Commissions[77].

Depending on the subject matter of the standard, due regard must be had to local conditions. As an example, comparison of national pension replacement rates (measuring pension entitlements as a share of individual lifetime average earnings) may be distorted by local tax treatment, differing relativity of lower income workers, lower eligibility ages and lower life expectancy rates[78].

On the local level, Australia's superannuation guarantee system is innovative and is difficult to compare internationally. While the guarantee system does not match the replacement rates offered by defined benefit schemes, it does, however, represent substantial progress towards national savings and attracts international acclaim.

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

We make no comment on this particular term of reference.

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[75] ASIC Media Release 05/148 "*Industry Fund Services Agrees to Change Advertising*" (3 June 2005).
[76] ss. 1041E-H of Corporations Act; ss.12DA–DB; 12DF of Australian Securities and Investments Commission Act 2001.
[77] Explanatory Statement to Corporations Amendment Regulations 2005 (No 1); p.9
[78] OECD Policy Brief "*Solving the Pensions Puzzle*" (March 2005) pp. 2-5

15 Any other relevant matters

(A) Avoiding disclosure of commissions

The existence of commissions is an essential element of fee disclosure to enable consumer comparability of a superannuation product and to provide consumers with a better understanding of the effect of fees and costs on their investment[79]. However, there are certain industry practices where disclosure of commissions may not be adequate. These practices are:

(a) Commission paid for procurement of members;
(b) Trail commission misdescribed as ongoing service commission; and
(c) Commission paid by an interposed entity.

(a) Commission paid for procurement of members

Various public offer funds pay commissions to advisers for recruiting employer sponsors that in turn generate new members. This can occur by:

- a fund agreeing to transfer its members into a larger adviser-recommended fund[80];
- an employer agreeing to join an adviser-recommended fund as an employer sponsor; or
- the employer agreeing to nominate the adviser-recommended fund as the default fund for the purposes of choice of fund[81].

According to the current law, certain conditions must be met before commission can be paid by a trustee of a public offer fund in consideration of a person:

- applying or agreeing to apply for the issue of an interest; or
- procuring or agreeing to procure applications for the issue of an interest.

These conditions include:

- the applicant for the issue of the interest has received prior written notification of the proposed payment; and
- the payment is not prohibited by the trust deed[82].

This means that in the case of a transfer of members into a new fund, the notification of the commission can be treated as applying to the employer or to the

[79] The PDS must include an explanation of adviser remuneration, including method of calculation; amounts of commission or the range; whether it is negotiable or rebatable and if so, how: item 209(e) Schedule 10 of Corporations Regulations.
[80] This does not require member consent provided that the new fund ensures equivalence of benefits, known as a "successor fund transfer": SIS Regs. 6.29(c); 1.03(1).
[81] This usually occurs on joining that fund as an employer sponsor (in the second scenario).
[82] s.154(1) of SIS Act; Reg. 3.10 (2) of SIS Regs.

trustee of the transferor fund [83] that makes the application for interests in the new fund (as opposed to the employees to whom interests are issued).

This way, the employees do not receive disclosure of the commission until they receive their Product Disclosure Statement which only occurs after the issue of the interest. In fact, disclosure can occur within 3 months after joining the new fund as a PDS can be given to standard employer sponsored members enrolled into a fund by their employer or a successor fund by another trustee within 3 months[84].

In turn, the PDS disclosure may not provide timely and targeted disclosure of the existence of procurement commissions in circumstances where the member is unaware of the adviser relationship with the employer or the trustee. While the existence of the commission is disclosed in the PDS, the source, nature and extent of the commission may not be adequately conveyed. Ordinarily, consumers are unlikely to appreciate that a commission is payable because of procurement advice provided to another person (their employer) and that the commission operates as an ongoing percentage extraction from the fund's assets.

These types of commissions beg the broader question of whether they are validly characterised as representing the procurement of superannuation interests. As these payments are percentage-based trails linked to the member account balances and to the life of each membership in the fund, one must question whether the volume of commission generated to the adviser has a sufficient link to the "service" to which it relates.

(b) Trail commissions

Many retail master trusts have arrangements to pay trail commissions to advisers as either a plan (employer) adviser or individual member adviser. These commissions are usually disclosed in a PDS as a payment for ongoing advice. However, in many cases, the ongoing service is either non-existent or minimal. The description of the commission as an adviser fee amounts to a failure to define the member services attracting the commission and acts as a misleading explanation of the nature of the payment.

On one view, this could represent:

- a breach of the trustee's duty to act in the best interests of the members[85]; and
- a breach of the fund's ASIC licence to conduct its financial services business in an efficient, honest and fair manner[86].

Similarly, if a trustee discloses a trail commission as a delayed payment for the initial service of dealing or advice (as is commonly the practice), the result is to mislead consumers. In fact, the trail commission is a reward for persistency of membership and is unrelated to services to members.

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[83] An application by an employer sponsor to join a public offer fund or an application by a trustee to arrange a successor fund transfer is treated as an application by the employer or trustee for a superannuation interest: s. 1016A(2) of Corporations Act.
[84] s.1012F of Corporations Act; Reg. 7.9.04 of Corporations Regulations.
[85] s.52(2)(c) of SIS Act
[86] s.912A(1)(a) of Corporations Act

The substantial amounts payable by trail commission are tied to a member's account balance which accumulates due to factors unrelated to the advice (such as recurring employer contributions over many years). This way, the trail commission bears no proportion to the service provided and represents a potential breach of the trustee's duty to act in the best interests of the fund members.

(c) Commissions paid by an interposed related entity

In the case of many retail master trusts, an adviser's commission is paid by an interposed entity that is related to the trustee, rather than being paid by the trustee itself.

As an example: AB Superannuation Pty Ltd (trustee of all AB superannuation funds) pays a management fee to AB Life Ltd. AB Life pays commissions to advisers out of this fee.

In this example, the trustee can claim not to be paying the commission. Nevertheless, this should be disclosed as the trustee has full knowledge of and consent to the payments. The payments may also amount to a commission for the procurement of an interest disclosable under the SIS legislation.

(d) Conclusion

Consumers are unlikely to appreciate the varied and complex nature of commission payments. The current disclosure regime governing commission payments (including both SIS Act and Corporations Act) causes potential for avoiding effective member disclosure. This highlights the need for clarity, consistency and consumer focused regulation of commission payments.

A fundamental premise of transparency of commission disclosure is that the commission should properly represent a fee for service. The Parliamentary Joint Committee on Corporations and Financial Services has welcomed moves towards providing fee for service[87]. Commissions that amount to a persistency or volume bonus are incompatible with the purpose of superannuation to provide retirement incomes in trust for the benefit of the members. Pending regulatory change, any commissions so earned should be rebated to the affected members. Rebates should be recommended in ASIC guidance.

In the interests of extending fee for service access to those who are unable to afford the immediate cost, we recommend that such fees be optionally deducted from members' accounts. The development of functionality for a direct fee deduction should be a recommended best practice. This is consistent with ASIC's policy of improving commission transparency through cultural change by industry co-operation and highlighting substandard industry practices[88].

Commission payments and approved product lists also attract a dangerous practice identified by ASIC of inducements paid by managed funds to advisers in return for including the fund on the adviser's approved product list[89]. This represents a potential to spread to the superannuation industry as competition increases.

[87] Parliamentary Joint Committee on Corporations and Financial Services "*Statutory Oversight of the Australian Securities and Investments Commission*" (August 2006); para.2.37
[88] ibid; para.2.44.
[89] ASIC Discussion Paper "*Managing Conflicts of Interest in the Financial Services Industry*" para B7.1

Together with legislative reform, there should be increased regulatory monitoring of commission disclosure consistent with the policy of full disclosure of all relevant fee information.

(B) The complexity of the superannuation system

The superannuation system is notoriously complex. The cause of this complexity is the legislative preoccupation with revenue protection. The proliferation of rules is designed to prevent abuse of tax concessions. Examples of anti-avoidance rules are the work tests for accepting contributions, release conditions for benefits, personal contribution limits and deduction rules[90]. Simplification of the superannuation tax system would sweep away the elaborate revenue protection measures and allow the legislation to focus on the core purpose of prudential and consumer protection.

We support the intent of the May 2006 Budget to simplify the superannuation system. However, we draw attention to the need to examine changes that remove one layer of complexity only to be replaced by a new layer of complexity. For instance, while the Budget proposal to remove tax on benefits has resulted in the removal of reasonable benefit limits, a countervailing complexity has emerged with an annual limit on personal deductible contributions for the purpose of deterring abuse of tax concessions.

Australia stands apart from most other developed nations which generally impose tax only at the benefit stage. The fundamental solution to simplifying the superannuation system is to limit tax to the end benefit. This means that contributions and earnings taxes will be removed. While this may represent a shift of government policy, it is consistent with the Budget Paper's acknowledgment that complexity needs to be reduced.

The removal of the contributions and earnings tax can be compensated by the new tax rates at point of exit. The enduring benefit for the government in deferring tax until exit is the ability for retirement earnings to grow without erosion of taxes throughout a person's working life and to strengthen incentives for a person to save for retirement.

In practical terms, implementation of this change will mean transitional rules for taxpayers straddling the old tax regime and the new tax regime. Transitional credits for tax paid under the old regime can be calculated actuarially. The short term complexity of transitional rules will be compensated by the long term gain of the overhaul of the superannuation system to ensure the freedom of contributions and earnings from taxation.

The principle of preservation of benefits is supported and would remain to ensure compulsory savings. However, the preservation rules[91] can be simplified as follows:

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[90] "*Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation*" (Productivity Commission; 2001) p.73: "*The underlying objective of the [contribution and payment] restrictions is to ensure that concessionally-taxed superannuation savings are used for retirement benefit purposes and, accordingly, to prevent abuse of taxation concessions".*

[91] This expression is used generically to describe the restriction on access to superannuation. It includes the benefit payment standards, conditions of release and cashing rules under the present legislation.

- early release (pre-age 65 and subject to the genuine retirement test, as at present[92]); and
- standard release (on age 65).

The standard release would operate free of any retirement, work test or condition of release. The standard release age of 65 can be aligned with the age 65 commencement of the old age pension and defines a common notional retirement age that opens access to retirement savings. The eligibility test for the old age pension would continue to be means tested to ensure that only deserving cases qualify for the government pension[93].

The standard release and removal of conditions mean that retirees could focus more clearly on drawing down their superannuation from a fixed age, encouraging individual planning and strengthening government revenue planning.

The removal of conditions post-65 (which is contemplated by the May 2006 Budget[94]) allows individuals to continue working, at their option, to supplement their retirement income. This encourages flexibility in a person's decision to retire. It diminishes the fear of a premature or irrevocable retirement with inadequate retirement income. It redirects public focus away from the government pension to self-help for retirement. This is in contrast to the system (prior to the Budget announcements) that requires the individual to leave the workforce as a condition of access to their superannuation account[95]. Funds would be free to offer post-release products in the same way as post-retirement products.

The simplification of the superannuation system encourages financial literacy, just as complexity hinders literacy. A pressing need for reform is the Product Disclosure Statement.

Instead of the present system of funds writing their own PDS documents having regard to complex content requirements[96], consumers need a prescribed PDS wording in laypersons' language. An example is the prescribed consumer warning of the duty of disclosure in general insurance contracts[97].

A standard worded PDS format is required to ensure certainty for the issuer, to assist comparability for the consumer and to exclude gratuitous promotional material.

The changes to the tax system and the preservation and contribution rules would significantly reduce the content of the new PDS. The need for a uniform PDS format has become particularly pertinent in light of the increased market pressures following the introduction of choice of fund.

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[92] Including the present incapacity, compassionate, financial hardship and permanent departure (temporary resident) rules.

[93] The recent removal of compulsory cashing rules post-65 is a step in this direction (APRA Modification Declaration 3 of 2006).

[94] By removing the compulsory cashing of benefits to members over 65 who fail to meet a current work test, thereby allowing members to keep their benefits in the fund indefinitely.

[95] Apart from the 2005 Transition to Retirement changes (allowing a non-commutable allocated or term allocated pension) introduced by the Superannuation Industry (Supervision) Amendment Regulations 2005 (No 2)

[96] For example, "general information about any significant taxation implications of financial products of that kind" (s.1013D(1)(h) of Corporations Act)

[97] Schedule 1 of Insurance Contracts Regulations 1985

The complexity of the superannuation system has overlooked the key principles of clear and concise information for consumers. The superannuation system should be both understandable and accessible.

(C) Competition for administrators

As administrators, we take this opportunity to make some comments about the competitive landscape for administrators.

The outsourced administration of superannuation funds is relatively concentrated in the industry and opportunities for competition should be encouraged in the public interest. In the current environment, public sector funds are generally administered by government owned administration companies. Public sector funds should be open to tender in the same way as private sector funds, which are required to conduct a due diligence process for the evaluation and selection of administrators[98].

As a matter of regulatory guidance, a relatively short term contract renewal should not require a fund to re-tender. In the interests of providing funds and their members with access to administration services at reasonable cost, regulatory guidance should contain sufficient flexibility to allow funds to reassess existing arrangements where a competitive price offer could make a material difference to the cost of fund administration. We recommend that if a fund receives an offer from an administrator to provide services of similar breadth and quality to funds and their members at a cost of 20% lower or more, the fund should be expected to enquire further and advise the enquiry outcomes in its annual report to members.

In the interests of consistent regulation and competitive neutrality, the regulatory guidance on outsourcing should be refined as above and be extended to public sector funds.

(D) The merging of regulators

The superannuation system is subject to two Federal Regulators, ASIC and APRA[99]. Superficially, the functions of the two Regulators are clearly divided with ASIC regulating consumer protection and corporate regulation, while APRA regulates prudential management and risk control of financial institutions.

However, in practice, this distinction is blurred. Consumer protection overlaps with prudential management and risk control. This is because consumer protection not only involves protection at point of sale (making an informed decision to invest) but also extends to ensuring the safety of the consumer’s investment. The safety of an investment in turns depends on the integrity of the risk controls (APRA) and the effectiveness of corporate governance (ASIC). Similarly, the system of corporate regulation protects not only consumers but buttresses the integrity of the national financial system. The failure of corporate regulation threatens the stability of the Australian economy.

In recent times, the distinction between ASIC and APRA functions has become more obscured with the ASIC licensing regime extending to superannuation funds,

[98] APRA SGN “Outsourcing” p. 7
[99] This excludes the taxation regulatory regime administered by the Australian Taxation Office.

rather than exempting funds to remain under full APRA supervision[100]. While risk management of a superannuation fund is regulated by APRA[101], risk management of a managed fund is regulated by ASIC[102]. Corporate governance of a non-superannuation corporation is governed by ASIC while a superannuation fund must comply with APRA-regulated rules of fitness and propriety for directors[103] and Board equal representation[104] as well as complying with the ASIC corporate regulation (in the case of corporate trustees).

On a daily administrative level, superannuation funds have an ASIC licence and an APRA licence, while being required to display (at differing levels) an ABN, an ASIC licence number, an APRA trustee number and an APRA fund number. Funds file various statutory returns with both regulators and are liable to on site audits by both. The obligation for funds to report regulatory contraventions is different for each regulator, with each regulator having a system for notifying the other of notified contraventions. Similarly, a fund must manage conflicts of interests under separate APRA guidelines[105] and ASIC guidelines[106]. A fund must administer member investment choice under APRA guidelines[107] and ASIC guidelines[108].

As stated in Term of Reference 4, APRA and ASIC licensing functions overlap in:

- risk management;
- organisational competence;
- adequacy of resources;
- indemnity insurance; and
- outsourcing.

In addition, regulatory overlap occurs in non-licensing areas, such as breach reporting and disclosure of commission.

A single regulator would solve the problem of constructing carve-outs to the ASIC licence regime for APRA-regulated funds[109]. This way, a single licensing regime (with conditions moulded to the particular financial service) can be implemented. As the ASIC name already contains the word “Investments”, a new name is not required.

In the superannuation industry, there is some confusion experienced as to whether a particular matter is governed by ASIC or by APRA. Translated to members of the

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[100] The extension to superannuation funds reflects a key recommendation of the 1997 Wallis Inquiry into the Australian Financial System for a unitary licensing regime for market conduct by all financial institutions. This meant that superannuation funds are now subject to an additional layer of legislation (Part 7.9 of Corporations Act) superimposed on the existing SIS legislation.
[101] ss.29E(c)-(d); 29HA-HC; 29P-PC of SIS Act.
[102] s. 601HA-JJ of Corporations Act
[103] SIS Reg. 4.14; APRA SGN.110.1 “*Fit and proper*” (July 2004)
[104] ss. 89, 92-93A of SIS Act.
[105] APRA SGN.110.1 “*Fit and proper*”; para.27
[106] ASIC PS 181 “*Licensing: Managing Conflicts of Interest*” (August 2004); see s.912A(1)(a) of Corporations Act
[107] APRA Superannuation Circular No.II.D.1 "*Managing Investments and Investment Choice*"
[108] ASIC PS 184 “*Delivery of Product Disclosure for Investment Strategies*”
[109] See Term of Reference 4 in this submission.

public, the confusion is liable to be compounded[110]. The effectiveness of a regulator is reinforced by the ease of identification of its functions.

With their repeated overlap in functions, there should be no cultural reasons against merging the two regulators. The two regulators have a fundamental common purpose of protection of the public and promoting confidence in the Australian financial system. The case for merging ASIC and APRA into a single entity is compelling.

While we recognise there have been efforts to reduce the regulatory overlap and clarify the demarcation between the two regulators, the fundamental issue of two regulators or one must be directly confronted. Any inquiry into the structure and operation of the superannuation industry cannot avoid consideration of this issue which goes to the heart of the effectiveness of superannuation regulation and the costs of compliance for participants in the industry.

Further information

If you require further information, please contact Paul Collins, Manager, Legal Services on 03/9200 4548 or on .mailto:pcollins@superpartners.com.au

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[110] Take the case of a promoter selling an investment scheme to the public funded by early (unlawful) redemption of their superannuation: one may ask, "*Is this ASIC or APRA?*"