MERCER
Human Resource Consulting

Mercer Human Resource Consulting Pty Ltd
ABN 32 005 315 917
33 Exhibition Street Melbourne Vic 3000
GPO Box 9946 Melbourne Vic 3001
03 9623 5552 Fax 03 8640 0800
john.ward@mercer.com
www.mercerHR.com.au

28 September 2006

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

Subject:
Inquiry into the structure and operation of the Superannuation Industry

Dear Mr Sullivan,

Mercer Human Resource Consulting Pty Ltd is very happy to provide comments on the issues raised in the terms of reference for this inquiry.

Mercer is well placed to comment as our operations encompass a wide spectrum of the superannuation industry:

- Mercer Investment Nominees Limited is a Registrable Superannuation Entity Licensee and acts as trustee for a number of superannuation entities including the Mercer Super Trust which has assets exceeding $ 10 billion;
- As a superannuation fund administrator we have provided administration services to a significant number of large corporate superannuation funds for many years;
- We also act as consultant and/ or actuary to many funds in both the private and public sector as well as to employers;
- Through Mercer Investment Consulting and Mercer Legal, we provide investment and legal advice to superannuation trustees;
- Mercer Spectrum acts as a Clearing House to assist employers in forwarding contributions to multiple superannuation funds;
- Our financial planning arm provides advice to individuals.

In these varied roles we have gained a wide understanding of the needs and problems of superannuation fund members, trustees, private and public sector employers, fund administrators and even the various regulators. It is our intention that our recommendations be based on a balanced view of the needs of each of these stakeholders.

A copy of our detailed comments and recommendations is attached. We have however listed our recommendations below:

Uniform capital requirements and requirement for trustees to be public companies

The introduction of uniform capital requirements and / or requiring all trustees to be public companies will not add significantly to the safety of superannuation and could possibly increase the risks. Each fund needs to consider the most appropriate means of financing costs arising from adverse events taking into account its own circumstances which would include the ability to call on existing capital, the level and scope of its trustee indemnity insurance, the ability to recoup losses from service providers, the level of employer support and any existing reserves.

Where there is a potential gap, then we believe that funds should be encouraged to consider establishing reserves to provide a buffer against adverse events, thereby providing members with some protection from such events. The advantage of a non-mandatory reserve is that it can be called upon when needed and rebuilt over a period of time. However, trustees would also need to consider the adverse impact on crediting rates during any period of establishing reserves.

The role of advice in superannuation

The definition of retail client should be amended to exclude employers who are not "small businesses".

The current requirements for providing advice to individuals are too onerous in relation to advice where the amount to be invested is small. This results in high relative costs or advice not being sought. The legislation needs to be amended to provide more flexibility in the processes around providing advice in certain circumstances, for example where the amount involved is below a specified limit or of a minor nature. This would enable individuals to obtain relevant limited advice at a more affordable price rather than no advice at all. Details of when such limited advice could be offered should be determined after consultation with the industry and we would be happy to participate in any such consultation.

To encourage the greater use of financial advice throughout the various life stages and hence enable current and future retirees to maximize their retirement income, the costs of all financial planning advice should be either tax deductible or subject to a rebate, at least up to an appropriate cap.

Member investment choice and the trustee's responsibility

APRA should revise its Circular II.D.1 to recognise the reality that trustees cannot be aware of the total circumstances of members and that although trustees must make information available on all options, any investment choice made by a member under member investment choice is ultimately the member's decision.

Self managed funds

Self managed superannuation funds have a place in the industry although the Government needs to ensure that there is appropriate monitoring to ensure that they are operating in a bona fide manner. In view of the number of such funds this will not be easy to achieve and would require additional funding for the Regulator to achieve this. One approach which could be adopted relatively easily would be to require any adviser who is recommending or helping to establish a SMSF to provide appropriate written material to the client setting out the trustee's duties and responsibilities, the investment restrictions, legal requirements and other practical issues involved in running a SMSF. Such compulsory material could be produced by say the ATO.

Defined benefit funds

Whilst much of the legislative change over the last 20 years has adversely affected defined benefit funds, it is now too late for the Government to fine-tune the legislation to make defined benefits more attractive. Any such fine-tuning is unlikely to result in a reversal of the trend away from providing defined benefit unless there was some element of compulsion. We do not see compulsion as an appropriate approach in today's environment.

Cost of compliance

The Corporations Act and associated Regulations should be rewritten so that they can be more easily understood.

The disclosure requirements should be reviewed and simplified so that funds are able to provide information that is clear, concise and effective.

Inconsistencies in the requirements of legislation, in particular the SIS Act and the Corporations Act, as they apply to trustees of superannuation entities should be removed.

Other legislative requirements should also be reviewed to determine whether they continue to serve a useful purpose.

ASIC and APRA should work together to develop a standard definition of 'materiality' for the purpose of breach reporting, and implement a streamlined breach reporting process, to minimize compliance costs to the industry.

Funding arrangements for prudential regulation

The superannuation industry is an important part of the economic infrastructure and its prudential oversight and sustainability is critical for the community as a whole. We therefore consider that the costs of regulation should be largely borne from Consolidated Revenue (including the tax revenue currently collected from superannuation funds). An annual registration fee could apply similar to the levy applicable to SMSFs.

Promotional advertising

The costs of promotional advertising should be able to be met from the fund subject to appropriate disclosure in Product Disclosure Statements and Periodic Statements.

"Not for profit" and "All profits go to members" terminology

Due to the possibility of these and other terms being used in a manner which implies lower fees even where this is not necessarily true, we consider that funds should be required to provide more detail when using such terms (refer to suggestions in attached report). The relevant regulator should also be alert and take action where words are deliberately misused or where they are likely to mislead consumers.

However, in a society where competition is encouraged, it is impractical to prohibit the use of certain words or phrases; rather clarity and transparency should be encouraged.

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28 September 2006
Committee Secretary
Parliamentary Joint Committee

Compensation

The financing of compensation to superannuation fund members should be met from Consolidated Revenue.

The current levels of compensation under the Financial Assistance Funding arrangements are appropriate.

The General Employee Entitlements and Redundancy Scheme should be extended to compensate for compulsory unpaid superannuation contributions.

Further comment

We would be happy to discuss our comments with the Committee when it holds its public hearings or at another convenient time. If you have any queries in the meantime, you can contact either John Ward (03 9623 5552) or David Knox (03 9623 5464).

Yours Sincerely

John Ward
Manager
Research & Information

28 September 2006

Inquiry into the Structure and Operation of the Superannuation Industry

Parliamentary Joint Committee on Corporations and Financial Services

MERCER
Human Resource Consulting

MMC Marsh & McLennan Companies

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WHETHER UNIFORM CAPITAL REQUIREMENTS SHOULD APPLY TO TRUSTEES

WHETHER ALL TRUSTEES SHOULD BE REQUIRED TO BE PUBLIC COMPANIES

In our view, these issues are closely related and should be considered as one.

The safety of superannuation is vitally important to Australia and Australians. For most Australians approaching retirement, superannuation will be their second largest asset behind the family home. Indeed, for others it may be their only financial asset.

From the Government's perspective, it is also vital that Australians' retirement savings are protected as well as encouraged, in order to minimize the long term Social Security costs.

It is also vital that the Australian community has long term confidence in the superannuation system.

To maximize the level of safety in superannuation, we believe that the following process needs to be undertaken for each superannuation entity:

1. Identification and evaluation of potential risks from a variety of sources;
2. Establishment of a risk management strategy/plan;
3. Determination of means of reducing the probability of adverse events eventuating;
4. Determination of means of minimising the cost impact resulting from an adverse event;
5. Regular monitoring of items 1 to 4;
6. An audit process to ensure that items 1 to 5 have been put in place and that the risk management strategy/plan is being acted upon.

We note that the above process is effectively already part of the requirements for trustees to obtain and maintain an RSE licence.

Whilst trustees have primary responsibility for the above process, we consider that APRA also has an important role in ensuring that the above process is followed and that appropriate risk mitigation arrangements are in place.

It is clear however, that despite the adoption of risk management strategies, it is inevitable that adverse events will occur. These events may be totally outside the control of the trustee (eg a global investment market crash or the need to significantly upgrade administration systems due to major legislative change).

Thus it is critical that proper consideration be given to minimizing the cost impact of potential adverse events (item 4 above).

There are a number of ways of covering or partially covering the potential costs. These include:

Cost mitigation	**Limitations**
Trustee indemnity insurance	▪ Covers certain risks resulting from fraud, mistakes, theft etc but will not cover many adverse events ▪ Cover may not be sufficient to meet the full loss
Insurance against specific risks	▪ Only covers losses due to specific events, eg fire insurance to protect against the loss of specialized systems and equipment
Payment under the Superannuation (Financial Assistance Funding) Levy Act	▪ Only covers losses due to fraudulent conduct and theft ▪ May be a considerable delay between event and receipt of assistance
Recoupment from suppliers who may have caused or been responsible for allowing the event to occur	▪ Only covers losses due to supplier error or omission ▪ Supplier may not have adequate financial resources (although trustees should ensure that their suppliers have appropriate insurance coverage or assets to meet any such claim)
The backing or guarantee of an employer sponsor	▪ Generally relevant in the case of Government sector funds ▪ Relevant to a lesser extent, to corporate funds ▪ Will depend on the ability and willingness of the employer to meet the costs at the time ▪ May not be available for retail or industry funds

Drawing down any reserves in the fund	▪ Will depend on the level of reserve and whether the reserve can be utilized in the particular circumstances ▪ Reserves are generally funded by members resulting in reduced crediting rates whilst the reserve is built up
Reducing interest crediting rate	▪ May result in adverse market perceptions leading to loss of funds under management, especially in a fund choice environment ▪ Has a direct impact on members in the year it occurs
Financial support provided by the product manager	▪ Will depend on the good will of the product manager ▪ Product manager may have an interest in protecting its "name" ▪ No guarantee that funds will be made available ▪ Generally only relevant to "with-profit" funds
Financial support provided from the trustee's share capital	▪ May or may not be made available
Drawing on the capital requirements ($5 million)	▪ May not cover the loss ▪ Once used it would need to be replaced immediately creating difficulties for the ongoing operation of the trustee

We note that not all of the cost mitigation options will be available to all funds. For example:

- Corporate and Government funds may be able to rely on the backing of an employer sponsor whereas this source would be unlikely in relation to a retail fund or an industry fund.

- Retail funds may be able to call on the backing of the product manager whereas this source may be unlikely in relation to an industry fund.

- An industry fund may be able to obtain compensation from say, a commercial fund administrator whereas a retail fund may be performing the administration role in house.

Each fund needs to consider all of the cost mitigation options that are available in its particular circumstances when designing its risk management strategy.

In particular, we consider it inappropriate to concentrate on capital requirements or share capital as a potential remedy. In our view, neither of these provides a total or practical

solution. For example, capital requirements are unlikely to be sufficient in an extreme or systemic event.

Capital requirements

We strongly disagree with the proposal to require uniform capital requirements for all trustees.

This issue has previously been canvassed by the Government in particular by the Government's Superannuation Working Group established to consider how best to increase the safety of superannuation in 2002. It was decided that no further action be taken.

In late 2001, the Government released an Issues Paper entitled "Options for Improving the Safety of Superannuation" which formed the basis of the Superannuation Working Group's focus.

This Issues paper gave three reasons for requiring all trustees to satisfy a capital requirement. These were:

- to demonstrate financial substance and long-term commitment by the Trustee;
- to have money at risk to provide an incentive to the Trustee to manage the fund well; and
- to act as a ready buffer against operational or governance risk that may arise.

Public Offer funds are currently required to meet a capital requirement although this can be satisfied in a number of ways.

However we do not consider that extending this requirement to all trustees will achieve the outcomes implied in the 2001 Issues Paper.

Since 1 July 2006, trustees of superannuation funds must have applied for and obtained an RSE licence. (The exceptions are self managed and exempt public sector funds.) To obtain such a licence, trustees have already demonstrated their long-term commitment and, whilst not necessarily financial substance, at least a substantial level of capability. These licensed trustees also undertook significant financial costs to update and establish strategies and procedures etc to justify the issue of a licence.

In the corporate superannuation fund environment the main priority of the Trustees (which includes member elected representatives) is to look after the best interests of the members. There is little or no incentive to take risks with the trustee directors generally being members of the fund as well as being employed by the same employer group.

We also seriously question the argument that the capital requirement provides a buffer against operational or governance risk. Firstly, a requirement of $5 million is, for a large fund, insignificant. Secondly, once used, it would need to be topped up immediately as the trustee could presumably not continue operating if it no longer met the minimum capital requirement. This raises questions as to how the top-up would be financed.

We consider that extending the capital requirements to all funds would result in:

- the demise of corporate funds, and possibly some industry funds, with a consequent reduction in competition;
- SMSFs becoming non-viable with a further reduction in competition.

The main issue for corporate and industry funds is how Trustees would raise such capital. The only source of funds for the Trustees of corporate or "not-for-profit" superannuation funds is the assets of the fund itself as it is highly unlikely that employer sponsors would be willing to meet this cost. Any such requirement would mean that the members of the fund would, in effect, be funding the capital requirements at the cost of a reduction in their benefits.

Clearly funds which are not subject to the capital requirement would need to place more emphasis on the other cost mitigation measures outlined above, for example the establishment of reserves to spread the cost impact of adverse events.

Public companies

The intention of this term of reference is unclear. For example, the term public company could refer to a listed public company, an unlisted public company, a company limited by shares or an unlimited company.

As indicated above, most large funds have been required to obtain a Registrable Superannuation Entity Licence. The vast majority of such licences have been obtained by companies, both public and proprietary. Only a small number of licences have been granted to groups of individual trustees.

It is also unclear as to why the Committee is considering a public company requirement. For example, is it in relation to capital requirements or other issues such as the holding of annual general meetings, additional reporting etc?

Corporate trustee versus individual trustees

We note that it has been possible for groups of individuals to act as trustees of a superannuation fund for many years. We are not aware of any particular difficulties that have arisen in relation to funds with individual trustees as opposed to corporate trustees.

In view of the additional licensing requirements that have recently been put in place, which already cover individual as well as corporate trustees, we see no reason why changes need to be made in this area. We expect that the likelihood of new funds being established with individual trustees is highly unlikely in any event.

What type of public company?

Without further detail on what the Committee means by the term "public company" it is also difficult to comment on whether this would add any additional security to members of superannuation funds.

For example, a public company might have only a limited amount of share capital. This may be insufficient to meet any unexpected costs. Further we note that the corporate trustee would be a separate entity to the fund and there would presumably be no guarantee that the public company would be prepared to use its share capital to prop up any superannuation fund it manages.

Further, where the public company is listed, takeover activity could result in the company being taken over by foreign interests or, of even greater concern, corporate raiders interested in fast money and little concern for the members of the underlying superannuation funds.

The concept of public company also implies that shareholders would require a return on capital which could potentially result in lower returns for members.

We therefore see such a requirement as leading to greater, rather than less risk.

To require trustees of corporate funds, industry funds and self managed funds to be established as public companies would seem to achieve no purpose other than to increase costs and reduce competition as these funds became less viable.

Presumably, exemptions would also be required for exempt public sector funds which are generally not set up as trusts but are established under Acts of Parliament.

To date, the Federal Government has not been able to legislate to impose the conditions of the SIS legislation or the Financial Services Reform legislation on these funds. Rather, compliance is obtained via agreements between the State and Federal Governments.

Recommendation

The introduction of uniform capital requirements and / or requiring all trustees to be public companies will not add significantly to the safety of superannuation and could possibly increase the risks. Each fund needs to consider the most appropriate means of financing costs arising from adverse events taking into account its own circumstances which would include the ability to call on existing capital, the level and scope of its trustee indemnity insurance, the ability to recoup losses from service providers, the level of employer support and any existing reserves .

Where there is a potential gap, then we believe that funds should be encouraged to consider establishing reserves to provide a buffer against adverse events, thereby providing members with some protection from such events. The advantage of a non-mandatory reserve is that it can be called upon when needed and rebuilt over a period of time. However, trustees would also need to consider the adverse impact on crediting rates during any period of establishing reserves.

3

THE RELEVANCE OF AUSTRALIAN PRUDENTIAL REGULATION STANDARDS

The terms of reference are unclear as to what aspects of superannuation were intended to be covered in this section. In view of the wide range of possible aspects which could be discussed, we have not made any specific comments at this time. We would be happy to provide comments on specific issues at a later date.

4

THE ROLE OF ADVICE IN SUPERANNUATION

The requirements of the Corporations Act have significantly increased the cost of providing financial advice in relation to superannuation. Hopefully, the requirements have also increased the quality and openness of that advice.

However there are some aspects of the requirements that need to be fine-tuned to improve the effectiveness of the legislation. In particular, there needs to be some loosening of the requirements in some circumstances.

Advice to large employers

One aspect of the legislative requirements that we consider is unnecessary is that employers, irrespective of size, must be treated as retail clients for the purpose of financial product advice in relation to superannuation products. There is no exemption for businesses that are not a "small business" (as defined) although such an exemption does exist in respect of large employers in relation to other financial products.

We also note that, in relation to superannuation, superannuation fund trustees (subject to a size test) and even some high net worth individuals do not have to be treated as retail clients.

The current requirement that employers be treated as retail clients results in unnecessary costs which could easily be avoided if the Corporations Act was amended to provide a similar exemption to that available in respect of other financial products. We understand that the Government is currently considering this issue.

Recommendation

The definition of retail client should be amended to exclude employers who are not "small businesses".

Advice to individuals

Individuals would generally benefit from financial planning advice at all stages during their life. However, there are several key stages at which proper advice is more likely to be required. These include:

- On changing employers or starting work where decisions have to be made about choosing a superannuation fund and/or consolidating superannuation accounts;
- On marriage or starting a family when insurance requirements need to be considered;
- Approaching retirement where decisions need to be made about transitioning to retirement, boosting superannuation savings etc; and
- At retirement when long term decisions need to be made in relation to investing their savings for retirement and, in many cases, qualifying for social security benefits.

We are concerned that the costs of obtaining proper financial advice are now so great that individuals will decide not to obtain that advice. This is particularly the case where the existing level of assets is small. The requirements of the Corporations Act effectively require that a full analysis of the individual's circumstances, financial situation etc is conducted and it is almost impossible to provide any advice for less than $700. We expect that few individuals will be prepared to pay those costs for advice in relation to, for example, consolidating an existing amount of $4,000 in one superannuation fund into another existing fund.

Recommendation

The current requirements for providing advice to individuals are too onerous in relation to advice where the amount to be invested is small. This results in high relative costs or advice not being sought. The legislation needs to be amended to provide more flexibility in the processes around providing advice in certain circumstances, for example where the amount involved is below a specified limit or of a minor nature. This would enable individuals to obtain relevant limited advice at a more affordable price rather than no advice at all. Details of when such limited advice could be offered should be determined after consultation with the industry and we would be happy to participate in any such consultation.

Tax deductibility

Currently the costs of financial advice to establish a financial plan are not tax deductible to the individual. Ongoing advice in relation to the plan may be tax deductible. More individuals would obtain financial advice if it was tax deductible.

However once superannuation becomes tax free after age 60 (as proposed from 1 July 2007) it becomes questionable whether any advice in relation to superannuation – at least for those over age 60, would qualify for a tax deduction as the superannuation is not producing assessable income. This is likely to lead to more confusion and again discourage individuals from obtaining proper advice.

We consider it important that individuals are encouraged to obtain financial advice so that they can best plan for their retirement. This is particularly the case because of the current low levels of financial literacy in the community. Whilst simplification of the superannuation tax system will help, many people are still likely to make financial decisions which are financially inappropriate, purely because of lack of knowledge.

Recommendation

To encourage the greater use of financial advice throughout the various life stages and hence enable current and future retirees to maximize their retirement income, the costs of all financial planning advice should be either tax deductible or subject to a rebate, at least up to an appropriate cap.

5 & 6

THE MEANING OF MEMBER INVESTMENT CHOICE

THE RESPONSIBILITY OF THE TRUSTEE IN A MEMBER INVESTMENT CHOICE SITUATION

As these questions are closely related, we have covered both in the same section.

Member investment choice is effectively the member:

- choosing an investment option or options offered by the trustee; or
- requesting the trustee to invest in a particular manner (although the trustee may have the ultimate decision as to investments made).

APRA's views

APRA has indicated its views on the responsibility of the trustee in Superannuation Circular II.D.1.

In particular APRA indicates that offering a broad range of investment options to members creates two potential prudential risks for trustees.

First, at the fund level, APRA considers that it is possible that a large number of members selecting the same or similar narrow investments would jeopardise the entire fund's diversification or liquidity position. As an extreme example, if a large proportion of members elected to put 100 per cent of their investment into illiquid real property vehicles, then at a later date these members elected to exercise their portability options in switching to another fund, then the fund's overall liquidity would be at risk. APRA believes that trustees need to manage the risks associated with members making sudden changes in their investment choices and formulate investment strategies with such contingencies in mind. APRA will take such strategies into account when forming a view as to whether trustees have complied with the requirements in s.52 of the SIS Act.

APRA considers that the second prudential risk in allowing unconstrained member investment direction is the risk that the member will choose an undiversified portfolio (such as a single equity or a highly volatile narrow asset class), and subsequent losses on this portfolio will greatly reduce the member's retirement income. APRA considers that this may lead to claims against the trustees by members.

APRA also finds it difficult to conclude that a trustee is acting in the best interests of members if narrow or risky choices are made available without regard to the amount or proportion of the member's interest that may be placed in the particular strategy. It considers that quantitative limits set by the trustee are one way to reduce concentration risk at the individual member level. For example, a trustee may require the members to hold a minimum of five separate stocks if single equities are offered as investment options. APRA does not believe that it is appropriate for the trustee to allow the member to take into account assets in other superannuation funds or other investments in establishing an investment strategy. Rather, the trustee must ensure that a diversified approach is taken.

Mercer view

In our view, APRA's approach is incompatible with the needs of some members, the Choice of Fund legislation that allows a member freedom of choice to choose a superannuation fund and other community trends in giving more choice to individuals.

In relation to illiquid investments, we consider that trustees should be able to place withdrawal restrictions on any such illiquid options. Such restrictions would need to be properly disclosed and could apply in relation to switching from the illiquid option to another option within the fund. It should also be possible for the restrictions to be imposed in relation to transferring out of the fund, however this would need legislative change to provide an appropriate exemption from the portability requirements. We expect that fully disclosed withdrawal constraints would result in members thinking more deeply about investing in such options and would enhance their understanding of the underlying assets.

The issue of a member selecting a narrow strategy (eg a single equity or a particular asset class) is of a concern where the member does not have a proper understanding of the potential impact. On the other hand, some members do have an understanding and believe that such a strategy, normally in conjunction with other assets outside the fund is most appropriate for them.

In our view APRA's approach would be akin to a trustee providing financial product advice to members without any (or limited) knowledge of each member's circumstances, financial situation, other investments etc. The APRA approach might be right for some members, for others it could be totally inconsistent with the member's needs and other investments. It is of course, totally impractical to expect a trustee (even if it had a Financial Services Licence) to take the member's total circumstances into account.

All trustees can realistically be asked to do is to ensure that members have the appropriate information and have been provided with warnings on the dangers of lack of diversification. We consider that the quantitative limits envisaged by APRA (Paragraph 45 of its Circular) are not appropriate.

Recommendation

APRA should revise its Circular II.D.1 to recognise the reality that trustees cannot be aware of the total circumstances of members and that although trustees must make information available on all options, any investment choice made by a member under member investment choice is ultimately the member's decision.

7

THE REASONS FOR THE GROWTH IN SELF MANAGED SUPERANNUATION FUNDS

There are a number of reasons for the considerable growth in self managed funds. These include:

- Members' desire for greater control over investments;
- A perception that fees are lower than those charged by retail funds, master trusts and industry funds. (For larger funds this may be true but for smaller funds, the converse may apply);
- Tax advantages
  - In particular, savings in capital gains tax are possible by retaining assets until the pension phase has commenced. In non-SMSFs, this is generally not possible - investment returns during the accumulation phase would generally be reduced by an allowance for tax on realised and unrealised capital gains and there is no simple and equitable mechanism to transfer some of the unrealised capital gains tax reserve to the member at the time of converting to a pension;
- A less onerous regulatory regime;
- Being "sold" by trusted advisers, accountants etc. In some cases it is likely that a self managed fund would not have been the most appropriate vehicle. We have seen various examples of individuals setting up an SMSF on the advice of their accountant or other adviser, without having been provided with sufficient information on how to operate the fund, the trustee's duties and responsibilities, the investment restrictions, legal requirements and other practical issues.

We agree that self managed funds can be entirely appropriate in certain circumstances.

In other cases the use of a SMSF may be inappropriate and can result in:

- Higher costs (at least for smaller asset levels);
- Lack of diversification in investments;

- Management problems when the key member dies or becomes incapable of managing the fund (eg one member was investment literate and successfully managed the fund for many years. The other member was not financially literate and was unable to properly manage the fund when the key member became too ill to continue;
- Inadvertent breaches of legislative requirements due to a lack of knowledge of the myriad of requirements of the superannuation legislation.

Self managed superannuation funds create additional difficulties for regulators. Clearly the large number of such funds means that it is not feasible for these funds to undergo the same level of regulatory monitoring as larger funds. The fact that the trustees and members are the same people also provides opportunities to circumvent the law (eg intentional breaches of preservation requirements). Further difficulties will arise following the introduction of anti-money laundering and anti-terrorism financing legislation where it is difficult to envisage a workable monitoring system.

Recommendation

Self managed superannuation funds have a place in the industry although the Government needs to ensure that there is appropriate monitoring to ensure that they are operating in a bona fide manner. In view of the number of such funds this will not be easy to achieve and would require additional funding for the Regulator to achieve this. One approach which could be adopted relatively easily would be to require any adviser who is recommending or helping to establish a SMSF to provide appropriate written material to the client setting out the trustee's duties and responsibilities, the investment restrictions, legal requirements and other practical issues involved in running a SMSF. Such compulsory material could be produced by say the ATO.

8

DECLINE OF DEFINED BENEFIT FUNDS

There has been a significant reduction in the provision of defined benefits over the last 10 years.

Many defined benefit funds have been wound-up or converted to accumulation arrangements over that time. In some cases, existing defined benefit members have been given an option of retaining their defined benefits although the defined benefit section has been closed to new members.

It is now difficult to envisage a circumstance in which an employer would establish a new defined benefit arrangement.

This is not an Australian phenomena as it is being replicated overseas, particularly in the UK, the US and Canada. However it is fair to say that Australia has led the way and is much further progressed in the move away from defined benefit arrangements.

However we should point out that defined benefit plans in Australia have generally been set up quite differently to those set up overseas. For example, most Australian funds had been established to provide, in the main, lump sum benefits. Most overseas defined benefit funds are set up to provide life time pensions.

Why has the reduction in defined benefit provision happened?

There is no single reason, rather, a number of issues have influenced employers, trustees and members to move away from defined benefits and to continue moving away. The following issues were some of those which led to this move.

The introduction of compulsory superannuation through awards in the late 1980s and Superannuation Guarantee in 1992 were slanted towards accumulation arrangements. Other legislative requirements eg the superannuation surcharge regularly seemed to add further complexities in relation to defined benefit funds.

Defined benefit arrangements also did not seem to be as flexible in coping with other business trends such as greater workforce mobility, total remuneration packaging, part-time workers and casualisation of the workforce.

Financial issues also played a part with employers becoming concerned with the potential liabilities that they might face in future and the impact of new international accounting standards.

In the Appendix, we have expanded on these and other issues which have impacted on the decline of defined benefit funds.

Rightly or wrongly, the move away from defined benefit funds has passed more of the risk from the employer to the employee. This would appear to be consistent with the Government's philosophy of offering employees choice of fund.

Recommendation

Whilst much of the legislative change over the last 20 years has adversely affected defined benefit funds, it is now too late for the Government to fine-tune the legislation to make defined benefits more attractive. Any such fine-tuning is unlikely to result in a reversal of the trend away from providing defined benefit unless there was some element of compulsion. We do not see compulsion as an appropriate approach in today's environment.

9

COST OF COMPLIANCE

We recognize that significant sums of money are held in the superannuation framework, and as a result, appropriately strong regulation of the industry is required to increase the safety of member's benefits. However, we believe that there are instances where the volume and complexity of the current legislative requirements, and the existence of a dual licensing system, mean that compliance costs are higher than they should be.

It is our view that a combination of a reduction in the legislative requirements and a simplification of these requirements, combined with some streamlining of processes, would result in a reduction in the legislative burden on trustees, while maintaining the integrity and robustness of the current system.

Continual change

Superannuation funds have incurred significant costs in implementing new systems, procedures and communicating changes to members following continual ad hoc changes to the rules.

We believe that the reforms announced in the May 2006 Federal Budget, where we saw far-reaching proposals aimed at genuine reform and simplification of the system, were well overdue. Prior to that, the 'tinkering' and patching of the systems resulted in an increased compliance burden, with little apparent benefits to members.

Some examples of ad hoc changes which have added to the cost of compliance include:

- Significant changes to the tax treatment of superannuation benefits were made in 1983. Yet only 5 years later, in 1988, the system was turned on its head with the addition of taxes on contributions together with a reduction in tax on benefits. The current system would have been far simpler if only one of these changes had been made so that superannuation would be only taxed at either the input or the output stage;
- The introduction of surcharge in 1996 resulted in significant implementation costs and ongoing administration costs (which were obvious from the start) yet it was not until 9 years later that this huge administrative burden was removed;

- The introduction of contribution splitting from 1 January 2006. This was an attractive concept and was implemented by many trustees who incurred significant implementation and communication costs. We expect that if these trustees had been aware of the comprehensive changes that were being announced in May 2006, many would not have introduced contribution splitting. Having already incurred costs and being concerned with adverse reaction that can result from removing options, trustees are effectively locked in to continuing to allow splitting, even though it is now of limited advantage to most members.

Ambiguous/badly written legislation

We are aware of many examples where superannuation legislation is unclear and where it appears that different Regulators have different interpretations of the same legislation. If the Regulators cannot agree on what the legislation requires, then how are trustees expected to understand the requirements?

Some recent examples of this are set out below:

Contribution splitting legislation: Contributions can only be split to a spouse who has reached their preservation age if the spouse has not satisfied a retirement condition of release. Despite concerns being raised during the consultation process, it is not clear what this requirement means in practice. APRA have provided their interpretation of this requirement in APRA Circular I.A.1. The ATO have provided their interpretation in the standard Contribution Splitting Form provided on the ATO website. It is concerning that these interpretations are not consistent.

Corporations Act: ASIC continually remind trustees that it is important that disclosure material be 'clear, concise and effective'. However, the Corporations Act, which specifies disclosure requirements, is written in a manner which is not clear, not concise and not effective. It is extremely difficult for anybody without considerable knowledge of the requirements to understand the requirements by reading the legislation.

Firstly, the language used in the legislation is totally inappropriate, using terminology that is not generally used in a superannuation context.

Secondly, confusion abounds because of the way the requirements have been laid out, partly in the Act, partly in Regulations, partly in amending Regulations which include not only amendments to the Regulations themselves but also amendments to the Act. Class Orders and Policy Statements issued by ASIC add further layers of requirements.

Poorly designed disclosure requirements

Product Disclosure Statements

To meet the requirements, it is necessary to prepare Product Disclosure Statements that are excessively long. Despite our best efforts, it is doubtful if they will be read and even less likely that they will be understood.

We recently had to prepare a PDS for a closed group of 3 pensioners, all in their nineties. The PDS was approximately 30 pages long (considerably shorter than most PDSs). Yet of these 30 pages, at most 4 paragraphs were of any relevance to the 3 pensioners. The pension payable was a defined benefit pension provided by the employer. No fees were payable by the pensioners and the employer was responsible to make up any shortfalls resulting from adverse investment performance etc. There was no facility to commute the pension. Despite this, the PDS had to include considerable detail of fees (all met by the employer-sponsor) and the investment option in use.

Newly issued PS 184

The requirements of Section 1012IA of the Corporations Act will apply to trustees of superannuation entities from 1 July 2007 and cover situations where a trustee offers an "independent" product as part of its investment choice offering. Recognising that the requirements in the Act would create difficulties for funds if left unchanged, Class Order Co 06/636 was issued giving trustees two options for complying with the requirements. ASIC also recently released Policy Statement 184 setting out its policy on how trustees can comply with the requirements. The modifications attempt to provide trustees with a more practical solution and offer two alternative approaches which would be considered to meet the requirements.

However, for many funds, even the alternative approaches are not practical. These funds may find that they have little choice but to remove the relevant investment options from their offering, as compliance with the requirements or alternatives will not be a practical option. This will limit the range of investment choices offered to members.

Short-form PDSs

The Regulations were amended late last year to allow trustees to issue short-form PDSs, provided a long-form PDS is provided to members on request. We do not believe that this is of benefit to the Trustee, as any Trustee who elected to prepare and distribute a short-form PDS, would also have to go through the cost and time commitment to develop and maintain a long-form PDS.

Periodic Statements (including disclosure of transactions)

It is our view that this legislation requires that the information contained in transactional statements may not necessarily reflect the factual situation. For example, administration fees of $1 may be deducted from a member's account each week.

The legislation appears to require that transactions be disclosed net of tax, so rather than showing amounts deducted of $1 each week, the transactional information provided should show deductions of $0.85 each week as the trustee can claim a tax deduction in respect of the administration fee and this is usually passed back to the member. We consider such an approach to be confusing and possibly misleading to members, particularly when the fee information in a Product Disclosure Statement is required to be disclosed before allowing for any available tax deductions.

Inconsistent legislation

One of the many difficulties faced by trustees is that they are subject to regulation by up to 3 regulators, APRA, ASIC and the ATO. They must also comply with a range of different pieces of legislation which are not all consistent.

We believe that there are instances where the regulation of superannuation funds can be streamlined, resulting in reduced compliance costs. An example of this is the current breach reporting process.

The tests that ASIC and APRA apply in respect of what breaches should be reported differ. In particular, APRA do not apply a materiality test in the same way as ASIC. In addition, there is no one standard breach reporting mechanism; as a result breaches may need to be reported both to ASIC and APRA, resulting in duplicated effort by licensees.

We recommend that ASIC and APRA work together to develop a standard definition of 'materiality' for the purpose of breach reporting, and implement a streamlined breach reporting process, to minimize compliance costs to the industry.

A further example is where a new Director is appointed to the Board of a corporate trustee. The following requirements apply, noting in particular the inconsistency in the timing of when advice must be provided:

1. SIS legislation: Section 29E(1)(f) requires that APRA be advised within **14 days**
2. Corporations Act: Section 205B requires that ASIC be advised within **28 days**
3. AFSL licensing requirements: If the person has also been classified as a responsible officer, ASIC must be advised within **10 business days.**

Yet the inconsistencies do not stop with inconsistent timing requirements.

For the purposes of the SIS legislation, all directors are treated as "responsible officers". For AFSL purposes, directors are not necessarily considered to be "responsible officers" but must be appointed to that position.

Other issues

There are many other legislative requirements which we consider could be either removed or considerably simplified. Some examples are discussed below:

Financial Sector (Collection of Data) Act

Trustees need to report considerable detail to APRA in relation to membership statistics, investments, income and expenditure etc – largely for the purpose of enabling various statistical analyses to be performed. We submit that the cost and effort of submitting the numerous forms to APRA is not consistent with the value obtained from this information.

Family Law

The provisions of the Family Law Act in relation to splitting superannuation and the associated sections of the SIS Regulations are highly complex and have been written in a manner that makes them difficult for superannuation trustees to understand, implement and explain. The complexity involved continues to add to the costs of complying with these requirements.

Identification numbers

Trustees and superannuation funds have many numbers. For example, a trustee may have an ABN, an ACN, a TFN, an AFS Licence number, and an RSE Licence number.

In addition, the fund itself may have an ABN, a TFN, an RSE Registration number, a SPIN and an SFN.

Many of these numbers have to be shown on various documents prepared by the trustee. A rationalisation of these numbers would simplify communication requirements.

Recommendations

The Corporations Act and associated Regulations should be rewritten so that they can be more easily understood.

The disclosure requirements should be reviewed and simplified so that funds are able to provide information that is clear, concise and effective.

Inconsistencies in the requirements of legislation, in particular the SIS Act and the Corporations Act, as they apply to trustees of superannuation entities should be removed.

Other legislative requirements should also be reviewed to determine whether they continue to serve a useful purpose.

ASIC and APRA should work together to develop a standard definition of 'materiality' for the purpose of breach reporting, and implement a streamlined breach reporting process, to minimize compliance costs to the industry.

10

THE APPROPRIATENESS OF THE FUNDING ARRANGEMENTS FOR PRUDENTIAL REGULATION

For a large fund, annual APRA levies can now exceed $150,000. Further significant increases in this levy are expected in future years. The levies result in either higher fees or lower investment returns for fund members. Whilst in percentage terms the impact is relatively small, the cumulative impact over many years is not insignificant.

For large well run funds, the levy can significantly exceed the costs of directly monitoring that particular fund.

On the other hand, the levy for self managed funds is clearly insufficient for any realistic monitoring to occur.

Superannuation is basically compulsory due to the requirements of the Superannuation Guarantee legislation. A clear objective of superannuation is to enable more Australians to be self-sufficient in retirement or at least to minimize the drain on Government resources through Social Security pensions as the population ages. This leads to the conclusion that it would be more appropriate for the Government to finance the costs of prudential regulation.

We also note that the Government draws significant tax revenue from superannuation funds due to the 15% tax on contributions and investment income. This tax income dwarfs the amount collected from APRA levies and we consider that a small part of that tax income could be used to finance the costs of prudential regulation.

Recommendation

The superannuation industry is an important part of the economic infrastructure and its prudential oversight and sustainability is critical for the community as a whole. We therefore consider that the costs of regulation should be largely borne from Consolidated Revenue (including the tax revenue currently collected from superannuation funds). An annual registration fee could apply similar to the levy applicable to SMSFs.

11

PROMOTIONAL ADVERTISING

Trustees are required to act in the best interests of members.

A trustee may consider that it is in the interests of members to both attract more members and retain existing members. A greater membership base will enable fixed costs to be spread more widely with a consequent reduction in fees charged to members.

It is therefore important that trustees consider how best to attract and retain members. Some ways of achieving this include:

- Employing a sales force remunerated either by salary or commission;
- Paying commission or other remuneration to financial planners or a related agency network; and
- Advertising.

Where considered to be in the interests of members, we see no reason why promotional advertising should not be allowed. Similarly we would consider that it should be treated as a valid expense of the fund and could therefore be paid for from the assets of the fund.

If this is not allowed, then similar arguments could be raised about financing other forms of attracting members such as payments to salaried or commission based staff and financial planners etc.

All of these marketing costs need to be met either:

- Directly from the fund and hence the members; or
- Directly by the trustee or product provider and indirectly by the members. (Where paid by the trustee or product provider, it is likely that these costs will be indirectly paid for by the members of the fund as part of their administration fee.)

Irrespective of how the costs are met, it is important that the costs borne by the fund be appropriately included as fees and charges shown in Product Disclosure Statements and Periodic Statements. We believe that this is already a requirement of the Corporations Act.

Recommendation

The costs of promotional advertising should be able to be met from the fund subject to appropriate disclosure in Product Disclosure Statements and Periodic Statements.

12

THE MEANING OF THE CONCEPTS "NOT FOR PROFIT" AND "ALL PROFITS GO TO MEMBERS"

Neither of these terms is defined and there are no guidelines on when they can be used. In many cases the use of the terms can be misleading. Generally they are used to imply to members and potential members that the costs will be less than in a "for profit" fund where the product provider is taking a share of the profits. Yet this implication is not necessarily borne out in practice.

To illustrate the issues, we discuss below the various types of fund:

Retail funds and wholesale master trusts generally operate on a for-profit basis. The product provider has generally contributed considerable initial capital to set up the fund and needs to achieve a return on that initial capital as well as making a "profit" for its shareholders to offset the risk it has undertaken. The fees charged to members therefore include a component to provide that return on capital and profit.

Industry funds are less likely to charge direct fees which include such profit components. However this does not necessarily lead to lower fees. Without any initial capital, it is likely that these funds would not have the ability to set up their own administration structure. Rather they would contract out the administration function to an administration company which may have been set up to make a profit. Other functions may also be outsourced to organizations aiming to make a profit. Thus whilst the fees charged to members do not include any direct profit to the product provider, they would allow for the fees charged to the administrator and other service providers which include an element of profit to those organisations.

Further, the trustee of industry funds would also employee staff to manage the fund. The employees are paid a salary which is generally controlled by the trustee. There would currently appear to be no real controls over the level of salary and or bonus paid to these employees. Whilst we are not aware of any particular cases, it would be relatively easy to pay these employees at above market rates and hence, in a roundabout manner divert "profits" to these employees.

Thus even though there may be no organisation directly taking profits from the fund, the administrator, other product suppliers and even employees could be indirectly making profits. This means that industry funds are not necessarily cheaper than other funds as is implied by the terms "not for profit" and "all profits go to members".

Corporate funds are perhaps those large funds that could most validly use the terms "not for profit" and "all profits go to members" as most are managed by trustee directors acting in a voluntary capacity. Further, some of these funds do not pass on fees to members with the employer sponsor effectively meeting the costs. However, as with industry funds, the administration function is usually contracted out to another organisation which is aiming to make a profit. Some corporate funds also allow the employer to utilise any surplus to offset the employer's contribution or even allow a return of surplus to the employer in certain circumstances (such provisions are more likely in defined benefit funds where surplus and deficits can arise due to deviations in the fund's actual experience compared with the experience assumed by the actuary in setting contribution rates).

In the light of the above comments, we have concerns over the use of the terms "non for profit" and "all profits go to members" in respect of any fund.

Likewise we are concerned with implications arising from the potential misuse of other terms. For example, some funds may use the term "We do not pay commissions". This may be a true statement. However it may be only part of the story and ignores the fact that the fund may incur other costs to obtain new members (eg advertising, salaries and bonuses to recruiting staff etc).

An extreme example could be a fund that currently pays commissions. It could change its remuneration policy and replace commissions with a combination of salaries and bonuses paid to staff. Even if this change increases recruitment costs, the fund could honestly claim that it does not pay commissions. In other words, a true statement could still mislead consumers into believing that the fund is lower cost.

We do not however, consider that banning the use of particular terms is workable. If particular words are prohibited, funds will develop other wording to get around the ban. These new words may be equally unclear and could similarly mislead consumers.

We also accept that, in a Choice of Fund environment, funds should be able to advertise and highlight the issues that might distinguish them from other funds.

So if banning certain words is not the answer, what can be done to minimise the risk of misleading consumers? It is difficult to determine an appropriate system that does not add even more layers onto the existing compliance burden.

However we would suggest that the following approach should be considered:

> Where a term that could be interpreted in different ways is used in advertising material, greater explanation should be provided.

For example, if the terms "not for profit" or "all profits go to members" are used, then additional disclosure should be required including whether any service providers are "related" to the trustee or the fund.

If the term "no commissions" is used, then additional disclosure should be provided in relation to the type of costs the fund incurs in recruiting new members.

The appropriate regulator should be alert to cases of advertising which is not factual or is misleading and take appropriate action.

We also note that from a member's perspective, the major issue is the fees that will be charged, not how the costs are built up. Funds are required to disclose fees in Product Disclosure Statements and hence should be able to demonstrate their lower fees where this is the case.

Recommendation

Due to the possibility of these and other terms being used in a manner which implies lower fees even where this is not necessarily true, we consider that funds should be required to provide more detail when using such terms (refer to suggestions above). The relevant regulator should also be alert and take action where words are deliberately misused or where they are likely to mislead consumers.

However, in a society where competition is encouraged, it is impractical to prohibit the use of certain words or phrases; rather clarity and transparency should be encouraged.

13

BENCHMARKING AGAINST INTERNATIONAL PRACTICE AND EXPERIENCE

The terms of reference are unclear as to what aspects of superannuation were intended to be covered in this section. In view of the wide range of possible aspects which could be discussed, we have not made any specific comments at this time. We would be happy to provide comments on specific issues at a later date.

14

LEVEL OF COMPENSATION IN THE EVENT OF THEFT, FRAUD AND EMPLOYER INSOLVENCY

Some protection is currently provided in the case of theft or fraud through the Financial Assistance Funding Levy. This levy effectively recoups the amounts paid under the Financial Assistance system to members of funds which have suffered from fraud and or theft. It is paid by other superannuation funds and hence by the members of those other funds.

In a Choice of Fund environment, one could question why there is a need for such a system. If an individual chooses a particular fund which turns out to be badly managed why should that person's loss be subsidized by those who chose a fund that was properly managed? Investors in the share market who invest in a stock that goes bad are not subsidized by those who invested in other shares. Why should superannuation be any different?

Whilst such questioning is valid, superannuation is not only compulsory but is also a critical part of the economic infrastructure. If there was no compensation in the event of a major superannuation fund fraud, then there could be a major loss of community confidence. This would be undesirable from the point of view of the Government, members, employers and the general community. It is therefore appropriate that some level of compensation be provided.

The more important questions are "Who should fund any compensation?" and "What level of compensation should apply?"

In relation to the funding of the compensation, we are concerned that the current arrangements effectively result in members of other funds meeting the cost. Whilst to date, the financing costs have been relatively small, this may not be the case in the future. With the reduction in the number of funds, a failure in one large fund could result in a very significant level of compensation being funded by members of other funds. This itself could lead to a loss of confidence where members of funds that have performed well are potentially significantly reduced.

In some cases, it may also be reasonable that part of the blame is placed on one of the Regulators for not taking appropriate action early enough. In such cases, there will be further questioning as to why members of other funds have to finance the compensation.

Due to the above reasons we consider that the financing of compensation should be met from Consolidated Revenue rather than from other presumably better managed funds.

At present, the Government's policy has been to limit compensation to 90% of the loss. As most members are able to choose the fund they belong to, it would appear reasonable that they should not be fully compensated. Otherwise, there would be less incentive to choose a well managed and "honest" fund.

Compensation in the event of employer insolvency is largely through the General Employee Entitlements and Redundancy Scheme (GEERS) and is directly funded by the Government. However no protection is provided in relation to compulsory superannuation contributions which have not been made by the employer before insolvency. As superannuation is now a basic part of employee remuneration, we believe that GEERS should be broadened to cover unpaid superannuation contributions.

Recommendation

The financing of compensation to superannuation fund members should be met from Consolidated Revenue.

The current levels of compensation under the Financial Assistance Funding arrangements are appropriate.

The General Employee Entitlements and Redundancy Scheme should be extended to compensate for compulsory unpaid superannuation contributions.

15

APPENDIX - Further background to the reasons for the decline of defined benefit funds

We have listed below a number of issues which have combined to contribute to the decline of defined benefit funds.

Financial issues

International accounting issues

- Employer concerns over proposals to include "profits" and "losses" from defined benefit superannuation fund operations in the financial accounts of the employer

Mortality improvements

- The effect of improvements in mortality has led to increased costs to provide pension benefits. This has led to many overseas funds experiencing financial difficulties. It has not had such a significant impact in Australia as few funds provide pensions.

Low interest rates

- Low interest rate environments also tend to result in higher costs of providing pensions. Again this has not been as significant in Australia.

Years of poor investment returns

- Poor and sometimes negative investment returns mean that employers need to make up the shortfall. In a competitive market place, employers have been less willing to risk increases in contribution rates flowing from poor investment returns.

Years of good investment returns

- During and following years of strong investment returns (for example during the mid 1980s and 1990s), members in defined benefit funds became envious of the significant growth in benefits achieved by members in accumulation funds which flowed from the high investment returns.

Cost

- The significant costs involved in producing regular actuarial valuations, benefit certificates, funding and solvency certificates, surcharge certificates, annual liabilities and costs for various local and international accounting standards.

Legislative issues

Australian legislation has generally made it more difficult to maintain defined benefit funds. Some examples are:

Contribution tax

- The introduction of tax on contributions and investment income in 1988 was the first major legislative blow to defined benefit funds resulting in either higher costs to employers or the need to reduce benefits provided. Reducing benefits raised complex equity issues and significant administrative and communication costs to implement. Member criticism of benefit reductions led to further disenchantment of employers.

Surcharge

- Badly drafted legislation led to much dispute between funds and the ATO/Government over the meaning of the initial legislation in relation to defined benefit funds, eventually leading to the need for significant legislative amendments;
- Significant costs were incurred in obtaining complex surcharge certificates to determine notional contribution rates;
- Significant costs were incurred to modify administration systems to cope with the additional complexities of surcharge for defined benefit funds;
- It was more complex to recoup surcharge payments from defined benefit members as there may have been no account balance to easily deduct the surcharge payment from. Instead, amounts paid had to be accumulated with interest and deducted from the end benefit;
- The surcharge methodology led to significant inequities for many defined benefit members where the surcharge paid was significantly greater than 15% of the benefit received;

- Trustees received a significant number of complaints, in particular from defined benefit members, which had to be dealt with.

Family Law

- It is more expensive to determine and provide the necessary information for members and their (former) spouses for members of defined benefit funds;
- It is more complex to split a defined benefit than an accumulation benefit.

Superannuation Guarantee

- The Superannuation Guarantee legislation resulted in some advantages as well as disadvantages for defined benefit funds. The major disadvantages again related to the additional complexity in calculating minimum benefits, the need to regularly update the actuarial Benefit Certificates and Funding and Solvency Certificates.

Disclosure

- The disclosure requirements of Corporations Law are extremely complex and have been designed for accumulation plans. There is little guidance in respect of how these complex requirements should be interpreted for defined benefit funds.

Treatment of pensions

- The relatively penal treatment of pensions from a tax point of view (relative to lump sum benefits), led to funds being designed to provide lump sums and generations of Australians growing up with a lump sum mentality;
- Complex (and regularly changing) requirements for pensions, with different rules for complying pensions for RBL purposes as opposed to the requirements for complying pensions for Social Security asset test exemption purposes, made it even more difficult for trustees to commit to providing defined benefits in pension form.

Return of surplus

- Legislative restrictions on the return of surplus assets discouraged employers from building up reserves whilst highlighting that a defined benefit fund was largely a one-way street with the employer being asked to meet funding shortfalls but not being readily able to access funding surpluses.

Prohibition of defined benefit funds

- The 2004 amendments to the SIS Regulations to prohibit new defined benefit funds of less than 50 members, and prohibit new members to existing defined benefit funds with less than 50 members probably came too late to have caused the decline in defined benefit funds. Nevertheless it was a significant disincentive to employers who were trying to maintain existing commitments to current defined benefit members, particularly as many funds were preparing to wind-up prior to 1 July 2006 due to the new licensing requirements. In order to transfer the existing defined benefits to another fund, it was often necessary to obtain an exemption from APRA.

Contribution Splitting

- The legislation does not allow contributions in respect of defined benefits to be split. If not for the Government's proposed tax changes from 1 July 2007, we would have expected a significant number of defined benefit members to opt out of their defined benefit arrangements so that they could participate in contribution splitting. (Once tax is removed from benefits payable from age 60, the advantages of contribution splitting will be largely removed.)

Transition to retirement

- We expect that many members will take advantage of transition to retirement strategies. From a legislative point of view, there is no bar to defined benefit members taking a transition to retirement pension; however, administrative difficulties are likely to mean that many trustees will not allow it. Rather, defined benefit members will be expected to convert to accumulation before the trustee will agree to issue a transition to retirement pension.

Remuneration issues

Total packaging/ flexibility

- Many employers have moved to a total fixed remuneration policy in which all remuneration is packaged. The provision of defined benefits (with an unknown cost) does not sit easily with such policies.

No longer an employment incentive

- Thirty years ago, the provision of superannuation was often driven by an employer's desire to attract and retain staff. Defined benefit plans with generous retirement benefits were often seen as a plus. The introduction of Superannuation Guarantee has led to the provision of benefits at the 9% level as the norm. In today's environment, employers seldom use superannuation as a mechanism to attract staff.

Higher contributions are generally arranged on a voluntary basis through salary sacrifice arrangements where desired by an employee.

Transition to retirement

- As more employers start to embrace transitioning to retirement policies in their workforce, this is more difficult for defined benefit members. Where benefits are based on final average salary, reducing salary in the years before retirement (by say working part time) can adversely impact on the defined benefit unless sometimes complex adjustments are made to ensure equity.

Part-time and casual workers

- The operation of defined benefit funds is more complex in relation to part-time and casual workers. This is particularly the case where the hours worked each week varies. Accumulation arrangements are more adaptable and able to cope with this increasing sector of the workforce.

Other issues

Workforce mobility

- The provision of defined benefits at retirement is much more straightforward if an employee remains with the same employer during their whole career. Where an individual regularly changes their employer, the provision of defined benefits can become disjointed. In any event it is not reasonable to expect that an employer will be prepared to continue providing benefits based on a person's salary near retirement age when the person left the employer's service many years before that. The increase in employee mobility has meant that many members of defined benefit funds did not remain in the fund long enough to receive their defined retirement benefit.

Investment Choice

- Generally investment choice is not available in respect of defined benefits. Some defined benefit members have switched to accumulation arrangements because they believe that they can achieve better results by choosing their own investment strategy.

Risk Pooling

- There has been a general community trend away from risk pooling to individual responsibility.

Mercer Human Resource Consulting Pty Ltd
ABN 32 005 315 917
33 Exhibition Street Melbourne Vic 3000
GPO Box 9946 Melbourne Vic 3001
03 9623 5555

MERCER
Human Resource Consulting