

29 September 2006

Sunsuper Pty Ltd  
ABN 88 010 720 840  
RSE Licence No. L0000291  
RSE Registration No. R1000337  
AFSL No. 228975  
Sunsuper Building  
30 Little Cribb Street Milton Qld 4064  
PO Box 1896 Milton Qld 4064  
Telephone: 07 3016 7794  
Facsimile: 07 3016 7786  
Website: [www.sunsuper.com.au](http://www.sunsuper.com.au)

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


Dear Mr Sullivan

Sunsuper welcomes the opportunity to make a submission to the Parliamentary Joint Committee on Corporations and Financial Services for its inquiry into the structure and operation of the superannuation industry.

The superannuation industry in Australia has undergone significant changes in the last decade including many positive initiatives to encourage savings and simplify the structure for all participants. With the recent announcements to further simplify this structure, it is an appropriate time to review the operation of the industry in a broader sense.

If you have any queries in relation to this submission or would like to discuss it further, please contact Bruce Wilson, Chief Operating Officer on 07 3016 7778.

Yours sincerely,

A handwritten signature in black ink that reads "Don Luke". The signature is written in a cursive style and is set against a light blue rectangular background.

**Don Luke**  
Chief Executive Officer

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## Introduction

Established in 1987 as an independent, multi-industry superannuation fund, Sunsuper now has over 900,000 members and \$9.5 billion in assets. Sunsuper became a public offer fund in 1999 and is an RSE registered fund.

The trustee of Sunsuper is Sunsuper Pty Ltd, an RSE licensee. The board of directors of the trustee is made up of equal numbers of employer and employee representatives. The trustee has an issued capital of \$6 and the shares are held by the employee and employer organisations which appoint their representatives to the board of directors. The fund is constituted so that no monies are paid from the fund to shareholders. The fund carries long-term reserves of \$xx at 30 June 2006.

Sunsuper has elected to respond to seven of the terms of reference of the inquiry. Adopting the numbering of the terms of reference, these are:

- 1 Whether uniform capital requirements should apply to trustees;
- 2 Whether all trustees should be required to be public companies;
- 4 The role of advice in superannuation;
- 6 The responsibility of the trustee in a member investment choice situation;
- 11 Whether promotional advertising should be a cost to a fund and, therefore, to its members;
- 12 The meaning of the concepts “not for profit” and “all profits go to members”;
- 15 Any other relevant matters where we address three additional matters.

# 1 - Whether uniform capital requirements should apply to trustees

## **Summary of Sunsuper's position:**

- (a) All superannuation funds should have access to some form of capital to manage operational risk; and that
- (b) The best way to protect the interests of beneficiaries of superannuation funds, particularly not for profit funds, is for the capital to be in the form of an operating reserve maintained within the fund.

## **Commentary**

*All superannuation funds should have access to some form of capital to manage operational risk.*

The Basel Capital Accord recognises three categories of risk for which capital is required - credit risk, market risk and operational risk.

Of these, only operational risk applies to superannuation funds. This is because superannuation funds and other investment managers that do not provide any form of guaranteed return on the investments managed, do not themselves bear any of the credit or market risk inherent in the assets under management; these risks are borne by the investor.

The Basel II, Revised Framework of International Convergence of Capital Management and Capital Standards, which is being introduced for Authorised Deposit Taking Institutions ("ADI") in Australia by APRA, includes methodologies for calculating the amount of capital to be held by ADIs in relation to operational risk.

Whilst the operational risks faced and the controls over those risks may differ in detail between superannuation funds and other financial institutions, the operational risks faced and the issues of measurement are substantially the same.

It would seem logical therefore, to implement a capital adequacy regime for superannuation funds, similar to that imposed on ADIs. Any such regime would need to take account of the absence of any credit or market risk and the particular regulatory regimes faced by superannuation funds, both of which would work to reduce the amount of capital required by superannuation funds as compared with ADIs. In addition, recognition would need to be given to the extent to which administrative services and the attendant risks of providing those services are outsourced by superannuation funds. The 'not for profit' sector of the industry has relied on outsourcing to a significant degree and through careful contracting, which is monitored by APRA, has been able to reduce the potential impact of certain operating risks. This should allow funds that outsource in this way to hold less risk capital than a fund that does not.

It should be noted that any move to implement a capital adequacy regime for superannuation funds will require a considerable lead time, both in determining the details as to how it will work and then in implementing it.

(b) *The best way to protect the interests of beneficiaries of superannuation funds, particularly not for profit funds, is for the capital to be in the form of an operating reserve maintained within the fund.*

Superannuation funds are trusts and do not take commercial risks in order to earn a profit. They exist for the benefit of members and, because of their unique position in the financial system, they and their trustees are closely regulated.

Each superannuation fund has a Trust Deed, which is administered by a trustee. The trustee is a separate legal entity whose responsibilities are onerous and governed by trust law as well as by a trust deed. Trustees may operate with a profit motive, but many, such as “industry fund” and corporate fund trustees do not.

In determining whether capital is required to manage the operational risks that could affect the assets of members of superannuation funds, it is important to make a clear distinction between superannuation funds and trustees.

There is a clear distinction between the capital required for a “for profit” business, such as a commercial trustee and the operating reserves that might be held by a superannuation fund. Operating reserves designed to protect the interests of beneficiaries of superannuation funds from operational risks such as inadvertent administrative errors should be held within the fund itself and not by the trustee. Reserves held within the fund can only be used for the benefit of members of that fund and cannot be paid as dividends to the shareholders of the trustee or used to cover the risks of other funds.

Such an operating reserve would be:

- Funded by the excess of member fees and charges less actual expenses, plus the investment earnings thereon;
- Separately accounted for and managed by the trustee in accordance with the trust deed of the fund and its general statutory and fiduciary duties;
- Expended only in the members’ interests with the consent of the board of directors of the trustee and their general reserve policy;
- Available to fund the development of services for the long-term benefit of members; and
- Available to meet the operational risks to the fund as they arise from time to time.

If a trustee only acts as a trustee for a fund or funds that maintain an adequate operating reserve as proposed and if the trustee does not operate for profit, there should be no requirement for the trustee to hold capital.

## 2 - Whether all trustees should be required to be public companies

### **Summary of Sunsuper's position:**

- a) The requirements of a public company appear to be inconsistent with the requirements of trustees of superannuation funds and therefore there should be no change in the requirements for trustees.
- b) Members of superannuation funds could benefit from additional disclosure of financial information similar to the disclosure requirements of Listed Companies. It would therefore be appropriate to consider mandating additional disclosure by trustees and superannuation funds similar to that required by Listed Companies.

### **Commentary**

- a) *The requirements of a public company appear to be inconsistent with the requirements of trustees of superannuation funds and therefore there should be no change in the requirements for trustees.*

The Corporations Act distinguishes between public and proprietary companies in:

- Appointment of directors
- Removal of directors
- Holding of Annual General Meetings
- Conflicts of interest
- Disclosure (Financial Statements and Directors' Reports).

Given that the shareholdings of most trustee companies are limited to a small number of shareholders, usually with restrictions relating to maintaining a balance of employer and employee representatives on trustee boards, it is difficult to see what benefits there would be for anyone, in particular members, should trustees have to be public companies.

Trustees are required under RSE licensing to prepare annual, audited financial statements. In effect this means they have the same reporting requirements as a public company or a "large proprietary company". As far as additional disclosure is concerned, there would be no changes if all trustees were public companies.

Sunsuper strongly opposes any requirement that all trustees be public companies.

- b) *Members of superannuation funds could benefit from additional disclosure of financial information similar to the disclosure requirements of Listed Companies. It would therefore be appropriate to consider mandating additional disclosure by trustees and superannuation funds similar to that required by Listed Companies.*

The Corporations Act requires Listed Companies to disclose more than other companies. It might be beneficial to members of superannuation funds if trustees were required to provide enhanced disclosure in areas such as directors' and executives' remuneration, attendance at board meetings etc.

Sunsuper supports a review of disclosure by superannuation fund trustees with a view to improving the disclosure available to members.

## 4 - The role of advice in superannuation

### **Summary of Sunsuper's position:**

*Education and advice are equally essential to helping members make decisions about their superannuation.*

*Sunsuper supports access to superannuation savings to fund financial advice relating to retirement, with appropriate protections. Improved clarity on the sole purpose test is required.*

### **Commentary**

Superannuation is one of the cornerstones of all working Australians retirement savings, yet there is clear evidence many people are not maximising their superannuation retirement benefits.

Several Government initiatives in recent years, including the co-contributions scheme, choice of fund, and the proposals in the 2006 budget are positive steps towards encouraging members to take ownership of their superannuation and plan for their retirement. However, the availability of these initiatives alone is not enough to persuade members to act.

We believe education and advice are equally essential to helping members make decisions about their superannuation and broader financial position. However, the traditional financial planning system doesn't cater to many members' needs, particularly young members on lower incomes with little discretionary spending.

Often, these members need advice on a particular superannuation issue, for example, selecting investment options, insurance cover, or determining appropriate contribution strategies. Acting on any one of these issues can have a significant effect on retirement outcomes. The main barrier to seeking advice for many of these people is access to appropriate and affordable advice.

We recognise that many superannuation members are in a suitable fund. Much of the advice about superannuation should therefore be strategic rather than product focussed, ie it should educate and facilitate decision making about improving retirement outcomes.

Allowing members to access a small amount of their superannuation savings to fund appropriate retirement advice can overcome this barrier to some extent. However, the sole purpose test under Section 62 of SIS limits the use of superannuation funds to advice concerning the superannuation product a member has invested in and superannuation advice generally. This prevents members funding advice on their overall financial position from their superannuation account.



We support access to superannuation savings to fund financial advice relating to retirement, however we acknowledge there must be appropriate protections on this to ensure it is not subject to abuse. The types of protection would include:

- An annual cap on the amount withdrawn from the account in the order of a few hundred dollars
- Adviser remuneration on a true 'fee for service' basis only
- Advice provided only by advisers approved by the trustee.

We also support improved clarity on the sole purpose test under Section 62 of SIS regarding the use of superannuation savings to fund financial advice.

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

### **Summary of Sunsuper's position:**

*The trustee is responsible for setting and managing the investment strategy at the fund level. However the trustee is not solely responsible for individual investment choice decisions made by members.*

### **Commentary**

Fund choice, member demand and new investment opportunities have driven a considerable increase in the number and types of investment choices available through superannuation. This will continue as account balances grow and members take greater ownership of their investments. The legislation relating to investments and investment choice has not kept pace with these changes resulting in some confusion about the responsibility of the trustee.

APRA issued the revised Superannuation Circular No. II.D.1 'Managing Investments and Investment Choice' in March 2006 explaining the requirements of the SIS Act for managing investments and investment choice.

Paragraph 5 of the Circular states 'When formulating an investment strategy the trustee is required to consider, at the entity level, the risk and likely return from investments, the diversification of those investments, liquidity requirements and the ability of the entity to discharge its liabilities. Where investment choice is offered, beneficiaries may choose between strategies that have been developed by trustees according to this framework.'

Paragraph 7 of the Circular states 'The underlying policy intent is that the provision of member choice of investment strategy does not remove the need for the trustee to ensure that the investment strategy or strategies of the fund comply with the requirements set out in the legislation.'

Most superannuation funds now offer investment choice as they represent members from many professions and industries with a broad range of investment needs. Sunsuper supports the offering of investment choice.

While the trustee should be responsible for setting the overall investment strategy for the fund, it seems incongruous that the trustee is solely responsible where investment choice is offered.

It is the trustee's responsibility to determine appropriate default strategies for the fund considering the requirements of the SIS Act. It is also the trustee's responsibility to determine the range of investment options offered.

However the trustee cannot be solely responsible for individual investment choice decisions made by members. The trustee is unable to determine a member's overall

financial situation. Many members hold more than one superannuation fund and/or both superannuation and non-superannuation investments to diversify their portfolios. It may be entirely appropriate for a member with broad diversification of investments to invest in a single asset class option with one superannuation fund.

Where investment choice is offered, the trustee has a clear responsibility to inform and educate members and provide appropriate warnings about some investments.

In summary, Sunsuper believes the role of the trustee is to:

- Establish the investment strategy at the fund level
- Determine appropriate default investment strategies for the membership of the fund
- Determine an appropriate investment option menu to be offered taking into consideration the needs of the total membership
- Educate and provide adequate information to enable members to make appropriate decisions about their superannuation investments
- Manage the investment option menu in line with the investment strategy.

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

### **Summary of Sunsuper's position:**

*The objective of advertising should be to inform and educate existing fund members. Advertising that achieves this is a legitimate operating expense of the fund.*

### **Commentary**

With the introduction of fund choice, superannuation has become a highly competitive industry with many different types of funds providing a range of retirement services. Fund choice has also led to a substantial increase in the amount of advertising across the entire industry.

This makes it increasingly important for members to understand the types of funds available and, more particularly, the fund they are in.

In Superannuation Circular No III.A.4 'The Sole Purpose Test', APRA specifies 'there should always be a reasonable, direct and transparent connection between a particular scheme feature or trustee action, and the core of ancillary purposes'.

We believe the primary objective of advertising should be to inform and educate existing members of the features and benefits of their fund. We acknowledge that advertising may also make potential members aware of a fund's product and service offering.

In its letter to all trustees of APRA regulated superannuation funds dated 14 March 2005, APRA stated '... expenditure on member retention and recruitment may be appropriate in limited circumstances'. It also stated '... the means by which information is provided to members is a decision for trustees and if trustees consider that education about the fund via the print or electronic mass media is the most cost effective way or reaching members, rather than individual communications, that is acceptable to us'.

Member retention is important in maintaining economies of scale. Economies of scale usually result in lower investment and administration fees and improved services for members.

Advertising is an integral part of improving member interest and participation in their fund. It enables funds like Sunsuper, with over 900,000 members, to reach large numbers of members cost effectively. Advertising complements other communication activities including disclosure documentation, member education, member reporting, and media relations. There is general acceptance that these activities are essential to the operation of a fund. Advertising to inform and educate members should be treated in the same way.

## 12 - The meaning of the concepts “not for profit” and “all profits go to members”

### **Summary of Sunsuper’s position:**

*These concepts are widely understood by the industry, legislators and regulators.*

*The intent of these types of funds is to retain some profits to cover operational risk and fund future development of services for the benefit of members.*

### **Commentary**

Sunsuper believes the concepts “not for profit”, “all profits go to members” and “profit-for-members” are widely understood by the industry, legislators and regulators to mean that any profits made are held within the fund for the benefit of members and not distributed to shareholders. The beneficiaries of all assets of the fund are members enabling the fund to concentrate on keeping costs low while providing services to benefit members.

It is important that legislators and regulators recognise the intent of these types of funds, which is to retain some profits to cover operational risk and fund future development of services for the benefit of members. These profits are held as a reserve within the fund as discussed in the term of reference regarding capital adequacy on page 4.

The “not for profit” concept can apply to industry, corporate and public sector funds, and as a marketing term, is a meaningful differentiator to fund members and employers between these funds and “for profit” funds.

## 15 - Any other relevant matters

### Superannuation Guarantee threshold

#### **Summary of Sunsuper's position:**

*Sunsuper supports the removal of the SG threshold to provide equity to all employees.*

#### **Commentary**

The Business Regulation Taskforce recently recommended an increase in the Superannuation Guarantee (SG) exemption threshold from \$450 to \$800 per month. Sunsuper applauds the Government for rejecting this recommendation on the basis it would have a negative impact on the retirement savings of low income employees.

Changing work patterns in recent years mean many employees are under threat of not receiving any superannuation contributions. A considerable increase in the number of casual and part-time employees means many of these workers will not reach the SG threshold. This is particularly the case for women who have a higher incidence of casual and part-time employment.

Sunsuper is a multi-industry fund catering for a broad range of members across many industries. Many of our members are in part-time or casual employment and many members achieve full-time employment status through multiple jobs. It is possible that although these members are effectively employed full-time, they may not receive any SG contributions.

Sunsuper is especially concerned about the ability for these employees to accumulate retirement savings and continues to support the removal of the SG threshold to provide equity for all.

### Appropriateness of compliance and complexity of Product Disclosure Statements (PDS)

#### **Summary of Sunsuper's position:**

*The current level of complexity in disclosure documents hinders member engagement and decision-making.*

#### **Commentary**

Sunsuper supports a strong compliance regime to protect the retirement savings of its members. However, we believe a level of complexity has evolved that is neither beneficial to members nor superannuation funds.

In Policy Statement 168 [PS168.7] 'Disclosure: Product disclosure Statements (and other disclosure obligations)' ASIC states, 'The broad objectives of a PDS are to help consumers compare and make informed decisions about financial products. To

achieve these objectives, the legislation requires that all information contained in a PDS must be worded and presented in a clear, concise and effective manner.'

The evidence strongly suggests these objectives are not being met. Many disclosure documents are lengthy, complex and technical. They do not help consumers compare products and they do not provide adequate protection for members. In fact they hinder member engagement and appropriate decision-making simply by their size and content. The short form PDS has not provided a suitable alternative.

One area where disclosure has improved markedly is fees and charges. These are now presented in a standard format. However we remain concerned about the treatment of investment fees, particularly regarding the calculation and disclosure of management costs and the indirect cost ratio. These fees are not uniformly treated across investment types and structures; therefore members are unable to fully compare investment options.

Sunsuper supports a review of this legislation to return to the original objectives of clear, concise and effective communications to help consumers compare products and make informed decisions about financial products.