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AIST SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Inquiry into the structure and operation of the superannuation industry

29 September 2006

A. AIST and its Members

1. The Australian Institute of Superannuation Trustees (AIST) is a national not-for-profit organisation whose members are superannuation fund trustee directors and officers of industry, public sector and corporate superannuation funds who operate with a representative Trustee Board of Directors. AIST provides professional training, consulting services and support to trustee directors and staff to help meet the challenges of managing superannuation funds and advancing the interests of their fund members.

   1.1 AIST has approximately 650 members from 120 Trustee Companies and Organisations. AIST members represent a significant number of decision makers in the superannuation industry, including member and employer Trustee directors, CEOs and other Executive Management from superannuation funds, as well as representatives from related organisations which service the superannuation and financial services industry.

B. Executive Summary

AIST's General Position regarding the Inquiry and its Terms of Reference	❑ AIST is concerned about substantial wide-ranging changes to super over the last five years and is not supportive of major change which would affect the underpinnings of the superannuation system, due to the fact it is unnecessary. The existing system is operating efficiently, is secure and has significant and robust regulation; ❑ AIST supports simplification of the superannuation system; ❑ AIST recommends a prohibition on commissions of any sort in return for advice in relation to superannuation (including commissions payable on Superannuation Guarantee contributions, rollovers/roll-ins, member or employer voluntary contributions); ❑ AIST supports further regulation and reform regarding the Self Managed Superannuation Fund ("SMSF") framework and specifically seeks legislation and regulations on the qualifications of persons authorised to properly give advice about creating and running a SMSF and in relation to SMSFs generally; and ❑ AIST recommends the removal of the $450 threshold for eligibly for Superannuation Guarantee contributions.

Term of Reference	AIST Recommendations
1. Whether uniform capital requirements should apply to trustees	❑ AIST does not believe that the industry or members of superannuation funds would benefit from any changes to the current capital requirements and that they are adequate.
2. Whether all trustees should be required to be public companies	❑ AIST does not support the proposition that all Trustees should be required to be public companies as it may not be appropriate for all types of superannuation funds, it will increase complexity in superannuation, is inconsistent with the Government's current attempts to simplify superannuation and will only increase compliance costs, which will be passed onto members. ❑ The requirement may also be inconsistent with the trust law and corporations framework under which superannuation is held in Australia, which adequately protects members' superannuation assets for retirement. AIST submits that each Trustee should be able to take into account the size, value and demographics of its own fund/s to determine which structure it should adopt, be it a public or proprietary company, or a group of individuals acting as Trustee.

Term of Reference	AIST Recommendations
3. The relevance of Australian Prudential Regulation Authority standards	❑ AIST does not support any change to the existing APRA Operating Standards and believes that they are both appropriate and required for prudential management of superannuation funds.
4. The role of advice in superannuation	❑ AIST submits that: i. there should be no commissions payable on Superannuation Guarantee contributions, voluntary contributions (either member or additional employer) or rollovers/roll-ins; and ii. the fundamental conflict of interests experienced by financial product advisers receiving commissions or other incentives by recommending certain products instead of others should be addressed via legislative means. ❑ This would alleviate the problems of lack of both impartiality and quality advice experienced by some consumers.
5. The meaning of member investment choice & **6. The responsibility of the trustee in a member investment choice situation**	❑ AIST does not support any change to the existing member investment choice framework OR any changes to a Trustee's responsibility in a member investment choice situation, as it is sufficiently covered by the *Superannuation Industry (Supervision) Act* 1993 and by the existing fiduciary obligations of a Trustee in terms of developing its Investment Strategies and asset allocations.
7. The reasons for the growth in self managed superannuation funds	❑ AIST submits that there should be further regulation for the Self-Managed Superannuation Fund sector, particularly with reference to when and how a financial product adviser (or other "professional") is permitted to recommend a Self-Managed Superannuation Fund.
8. The demise of defined benefit funds and the use of accumulation funds as the industry standard fund	❑ AIST submits that whilst defined benefit funds have a significant role to play in the superannuation system of Australia, accumulation funds are more common and can offer members an accurate representation of their expected retirement benefits, provide portability and flexibility which is relevant to today's employment practices, and provides employers with certainties as to costs of superannuation.
9. Cost of compliance	❑ AIST submits that the cost of compliance on superannuation Trustees covers all aspects of a Trustee's operations and involves both direct and indirect costs to continue to comply with such significant and wide ranging pieces of legislation which affect superannuation fund Trustees.
10. The appropriateness of the funding arrangements for prudential regulation	❑ AIST submits that the current method of funding for prudential regulation is adequate, equitable and transparent.

Term of Reference	AIST Recommendations
11. Whether promotional advertising should be a cost to a fund and, therefore, to its members	❑ AIST submits that the cost of promotional advertising should be a cost to the fund, and therefore its members, consistent with any other financial institution or business. These costs are not inconsistent with the SIS "sole purpose test" or with the "run only to profit members" or "not for profit" structures, and are necessary parts of running a business, especially in a "Choice of Fund" environment. Promotional advertising also encourages a competitive superannuation industry, which benefits members and their retirement savings.
12. The meaning of the concepts "not for profit" and "all profits go to members"	❑ "Not for profit" is a widely understood and commonly used term within the community. In the superannuation industry, it is used to differentiate superannuation funds which are established solely to benefit members from those established to also profit shareholders or other individuals. ❑ Many of AIST's members identify as "run only to profit members" style superannuation funds (also known as "all profits go to members" and as "not for profit"). AIST submits that these terms are essentially marketing terms used to distinguish those funds from other funds who pay dividends to shareholders as well as returns to members' accounts. ❑ "Run only to profit members" or "not for profit" style funds return all earnings to members (as distinct from shareholders or other related parties), less taxes, fees and costs. Members receive a declared net crediting or earning rate on their superannuation accounts. There are no shareholders who compete with members for returns or profits.
13. Benchmarking Australia against international practice and experience	❑ AIST submits that benchmarking Australian superannuation system against international practice and experience will result in Australia's system being found to be one of the best retirement systems in the world and a leader amongst OECD nations.
14. Level of compensation in the event of theft, fraud and employer insolvency	❑ AIST submits that the current framework for compensation for theft and fraud in a superannuation context are adequate. In relation to employer insolvency, AIST submits that the Superannuation Guarantee legislation should require that employer contributions are received monthly and not quarterly, to guard against employer insolvency and loss of members' retirement benefits.
15. Any other relevant matters	❑ AIST submits that the $450 threshold for eligibility for Superannuation Guarantee contributions be removed as it is inequitable. Its removal would also ease some of the regulatory complexity on employers in relation to superannuation.

C. Summary of AIST's views on superannuation in Australia

Significant past and proposed changes for the superannuation industry

2. AIST is concerned about further change within the superannuation industry given the recent substantial and wide-ranging changes which have occurred in the last five years. These changes have included:

   - APRA's recent 'Registrable Superannuation Entity Licensing' ("RSE Licensing"), effective 1 July 2006;
   - ASIC's Australian Financial Services Licensing regime, effective 11 March 2004;
   - Super Fund Choice implementation;
   - Anti-Money Laundering & Counter Terrorism measures (yet to be finalised, with unclear application to the superannuation industry);
   - The Government's FSR Refinements processes, the 'Taskforce on Reducing the Regulatory Burdens on Business' and the recent 'Outcomes of Consultation on the Plan to Simplify and Streamline Superannuation' via the Budget 2006 changes;
   - Previous wide-ranging reforms relating to the application of the Privacy Act to the superannuation industry;
   - The introduction of allowing divorcing couples to split superannuation;
   - Then other significant changes such as contribution splitting, government co-contributions, bankruptcy and superannuation contributions, accounting standards amendments and dollar disclosure requirements.

3. These changes have all had an enormous affect on AIST members (superannuation fund Trustees), and has resulted in increased legal and compliance costs encompassing significant overhauls in superannuation fund operations, systems and procedures. RSE Licensing was too much for some of the smaller superannuation funds, as they have wound up, transferred to other funds or amalgamated.

4. In addition to this, the 2006 Budget reforms have caused further change and disruption to normal superannuation fund operations. Without legislation and regulations to explain how these changes will be implemented by Trustees of superannuation funds, it is unclear how these changes will be managed and what affect they will have on members. The proposed changes cover such a broad range of topics and affect many complicated areas of superannuation operation and administration. These changes, once legislated, will require fundamental changes in the way superannuation funds function.

5. AIST is concerned that further unnecessary changes to superannuation will not only adversely affect superannuation funds, but that members of superannuation funds will see further changes in a negative light,

resulting in a further lack of faith in, and engagement with, their superannuation. Research has shown that superannuation fund members view the constant change to the legislation affecting their superannuation negatively and accordingly lose confidence in superannuation and whether it will "still be there" in the future, when they retire. This lack of confidence in the integrity of the superannuation system is inconsistent with the need to encourage superannuation fund members to understand their superannuation and save for their retirement.

SIS Covenants – the strong backbone of superannuation system

6. In further support of AIST's position of maintaining the current superannuation regime are the Trustee Covenants contained in section 52 under the *Superannuation Industry (Supervision) Act* 1993 ("SIS").

7. These Covenants must be followed by all Trustee Directors in performing their duties and in operating the superannuation fund. Under SIS, these covenants must be contained in the Trustee's Trust Deed, and if they are not, then they are deemed to be contained within the Deed.

8. The SIS Trustee covenants are[1]:

   (a) To act honestly in all matters concerning the entity;

   (b) to exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as an ordinary prudent person would exercise in dealing with property of another for whom the person felt morally bound to provide;

   (c) to ensure that the trustee's duties and powers are performed and exercised in the best interests of the beneficiaries;

   (d) to keep the money and other assets of the entity separate from any money and assets held by the Trustee personally or by the employer sponsor or associate;

   (e) not to enter into any contract, or do anything else, that would prevent the trustee from, or hinder the trustee in, properly performing or exercising the trustee's functions and powers;

   (f) to formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the entity;

   (g) if there are any reserves of the entity—to formulate and to give effect to a strategy for their prudential management, consistent with the entity's investment strategy and its capacity to discharge its liabilities (whether actual or contingent) as and when they fall due;

   (h) to allow a beneficiary access to any prescribed information or any prescribed documents.

9. AIST submits that these covenants, which are taken extremely seriously by Trustees, further dovetail in with the APRA RSE Licensing Regime, to build a strong, sound and prudentially managed superannuation system to protect members' retirement savings.

[1] SIS, Section 52(2)(a)-(h)

10. AIST further submits that these Covenants are the backbone of the superannuation industry. When SIS was enacted, these Covenants were crafted so well and so strongly that they have stood the test of time over the last 13 years. They remain as the guiding principles behind superannuation, and have been both appropriate and successful in protecting members' benefits. In Australian history, there have not been any collapses or major frauds involving a superannuation fund (with a representative Trustee) due to Trustee mismanagement. This is attributable, in part, to these Covenants. AIST submits that there should be no change to the SIS Covenants.

AIST supports simplification of the superannuation system and provides recommendations for some reform

11. AIST submits that the super system needs further simplification. The Budget and the additional changes presented by the Government on 5 September 2006 have gone some way in simplifying the system, but there is more than can be done. There are many benefits in making the system easier for superannuation funds to administer, easier for both members and employers to understand, which will assist regulators and other stakeholders to properly perform their roles and obligations under the system. To that end, AIST supports reform which simplifies the following areas of superannuation:

    (a) **Measures which will assist in automatically consolidating lost member accounts, or inactive accounts.** Given that there is over $8.2 Billion dollars in inactive or lost superannuation accounts, which affects over 5.4 million Australians, the ATO should be given authority to find those lost/inactive accounts and automatically roll them into members' current superannuation accounts, as nominated by the member[2];

    (b) **A broader application of the 9% Superannuation Guarantee amount**. Every worker in Australia, regardless of how much they earn each month, should be entitled to receive the 9% Superannuation Guarantee. This would also facilitate easier administration for employers, as they would not require the complicated tracking systems of their employee's monthly ordinary time earnings. Employers would know that every employee was entitled to receive the 9% of their salary to their nominated superannuation fund;

    (c) Further, that the **9% Superannuation Guarantee amount be calculated on pre-salary sacrifice wage or salary**;

    (d) **The prohibition of exit fees in any form**, specifically the prohibition on penalty exit fees as they are anti-competitive and a barrier to superannuation fund choice and consolidation of multiple accounts (a reasonable administration fee to administer the transfer would be permissible);

    (e) **A review and simplification of the disclosure requirements** originally imposed under the FSR regime, which have since been

[2] AIST acknowledges and commends the Government's Budget 2006 proposals in relation to lost member initiatives, but would like to see the proposals go further.

amended, expanded and "refined", as they do not meet their objective of creating "clear, concise and effective" communication documents for members. This is particularly evident when considered in the context of Product Disclosure Statements. These overcomplicated disclosure requirements are not only costly and difficult to implement at a Trustee level, but they do not provide members with all they need to know in an easy to understand way. The level of detail required to be included is off-putting to members and rarely read in full.

12. AIST submits that **the areas of superannuation which require immediate reforms relate to the payment of commissions on superannuation in return for advice and also in relation to Self Managed Superannuation Funds ("SMSFs")**.

    12.1 Commissions payable to financial advisers on any kind of superannuation contributions and rollovers should be prohibited by law, as they erode members' retirement income. AIST supports reform in this area as a way to remove some of the fundamental conflicts of interest which arise in the current advice framework.

    12.2 The interests of persons who provide financial product advice who are paid commissions or incentives as a result of recommending certain superannuation funds or products are in direct conflict with superannuation fund members who need impartial and independent advice about superannuation or other financial products.

    12.3 ASIC's "Shadow Shopping" Report, issued in April 2006,[3] has shown that despite undertakings by the Financial Planning industry to address areas of concern in the giving of financial advice, there are still significant problems in relation to the appropriateness of advice given by financial advisers who are paid by commissions. AIST strongly supports reform in this area.

    12.4 AIST submits that further regulation is also required in relation to the SMSF sector, particularly in relation to the qualifications of the persons who are authorised to provide financial product advice about SMSFs and the type of information which is provided to clients when advisers recommend SMSFs.

    12.5 AIST's recommendations are discussed more fully below, in Part D of the Submission.

[3] Refer to Term of Reference 4 for more information about this report.

D. AIST's Submissions

TERM OF REFERENCE 1 – WHETHER UNIFORM CAPITAL REQUIREMENTS SHOULD APPLY TO TRUSTEES

RECOMMENDATION 1

AIST does not believe that the industry or members of superannuation funds would benefit from any changes to the current capital requirements and that they are adequate.

Legislative Provisions

13. One of the changes implemented as an "Operating Standard" under APRA RSE Licensing was the need for a Public Offer RSE Licensee to have "net tangible assets" ("NTA") of at least $5 Million held either:

    (a) in the Trustee's own right;

    (b) under an approved guarantee, where the Trustee relies either wholly or in part on a deed of guarantee to meet the $5 Million NTA requirement;

    (c) as a combination of NTA and approved guarantee; or

    (d) by a Custodian on behalf of the Trustee (if the Custodian holds the $5 Million NTA, the RSE Licensee must maintain $100,000 in NTA to meet ongoing obligations.[5]

14. Sub-regulation 3A.04 of the *Superannuation Industry (Supervision) Regulations* 1994 ("SIS Regulations") provides the formula by which a Trustee's NTA is calculated.

APRA's reasoning for the NTA requirements

15. APRA considers that these NTA requirements provide some financial resources to act as a buffer against risk, to show evidence of a commitment on behalf of the Trustee to its superannuation business and to act as an a incentive to manage the entity well. The NTA requirement is an ongoing Licence Condition which must continue to be met at all times.

16. As part of the NTA requirements, APRA ensures that RSE Licensees have and maintain a robust system to manage their capital positions for both current financial issues and sustainability in the long term. In addition, the Adequacy of Resources Operating Standard and the Outsourcing

[4] Refer to Term of Reference 4 for more information about this report.

[5] *Superannuation Industry (Supervision) Act* 1993 ("SIS Act") sections 26 and 29DA & *Superannuation Industry (Supervision) Regulations* 1994 ("SIS Regulations") regulation 3A.04.

Operating Standard imposed additional requirements on RSE Licensees, which has only further strengthened the capital requirements for Trustees.

17. The NTA capital requirements were never intended to exist for compensatory purposes. They were never intended to be drawn upon to "compensate" members for loss of benefits.

AIST's reasons to maintain the current capital requirements

18. AIST Members (most of whom are Directors on Trustee Companies) are constantly reviewing their solvency and capital situation as a part of their ongoing monitoring requirements under their RSE Licence Conditions. Any deficiencies in relation to capital would therefore be discovered early on via this regular monitoring. Appropriate action would then be taken to mitigate and resolve solvency deficiencies.

19. Many "not for profit" funds (for example, industry, corporate and public sector funds) already have a form of capital set aside for operational risk. That is, many funds have general reserves, investment reserves and other reserves to provide a back-up should an error arise that cannot be funded through other avenues.

    19.1 Generally, these reserves are owned by the fund and income is earned on the reserves for the benefit of members of the fund. These reserves are held in an environment where much of the Trustee's risk is outsourced to fund managers, custodians and fund administrators.

20. When Trustees outsource various activities, as part of their due diligence procedures, they ensure that such service providers have the required resources, including capital, to manage their activities. These are requirements under the APRA RSE Licensing Regime.

    20.1 Outsourced service provider contracts provide a level of protection to the Trustee through the use of service standards, maintenance of professional indemnity insurance, disaster recovery and business continuity plans, indemnification provisions and so on. Given this, fund Trustees who outsource their activities have minimal need for capital as they have outsourced the operational risk of their fund. However, many master trusts perform the investment management, custodian and administration functions in-house and as such they do need such capital as they are carrying all of the operational risk.

21. Also, should a Trustee or Fund experience a fraud, and the Trustee is unable to recoup the loss from the relevant service providers who are at fault for allowing the fraud to occur, there are two other options for Trustees. They are able to claim on their Trustee Liability insurance policy, and there is also provision in SIS which enables the Trustee to recoup those losses from the levy collected via the *Superannuation (Financial Assistance Funding) Levy Act* 1993. (Discussed more fully in Term of Reference 14.)

22. In addition, many Trustees have opted for the $5 Million net tangible assets to be held under an approved guarantee or by its Custodian on behalf of the Trustee as a risk management technique, as the Australian

superannuation Trustee Custodians (eg National Australia Bank Limited, JP Morgan Chase Bank, ANZ Custodian Services) are generally financially sound and financially well backed to manage this kind of capital. It also helps the Trustee companies from an accounting perspective and maximising assets and investments.

23. Further, if superannuation is viewed as any other investment, it is somewhat unique in the requirement of having the $5M net tangible assets. Consider an investment in the share market – there is no such assurances regarding solvency for any shareholder investing in shares.

TERM OF REFERENCE 2 – WHETHER ALL TRUSTEES SHOULD BE REQUIRED TO BE PUBLIC COMPANIES

RECOMMENDATION 2

i. AIST does not support the proposition that all Trustees should be required to be public companies as it may not be appropriate for all types of superannuation funds, it will increase complexity in superannuation, is inconsistent with the Government's current attempts to simplify superannuation and will only increase compliance costs, which will be passed onto members.

ii. The requirement may also be inconsistent with the trust law and corporations law framework under which superannuation is held in Australia, which adequately protects members' superannuation assets for retirement.

iii. AIST submits that each Trustee should be able to take into account the size, value and demographics of its own fund/s to determine which structure it should adopt, be it a public or proprietary company, or a group of individuals acting as Trustee.

Current trustee framework & regulators

24. Generally, most superannuation funds in the industry hold superannuation assets on trust through a corporate trustee company. The trust structure is entirely appropriate for the superannuation regime as it provides safety for members' superannuation assets. In addition, SIS provides covenants and duties to Trustees to ensure superannuation is treated within the trust framework.

    24.1 The trust framework creates a fiduciary relationship between the trustee and the members of the superannuation fund and the Trustee holds the title of the superannuation assets for the benefit of the members. This is a very important basis to superannuation in Australia as a protection mechanism of members' retirement savings.

24.2 Currently, Trustees are able to choose which style of trust structure it will employ – either a group of individual directors (less common) or directors of a corporation, which can include a proprietary company (which significantly more common in the superannuation environment) or a public company. The trust framework applies to either option.

24.3 As a general rule, the difference between a proprietary company and a public company is that with the latter, there are more stringent disclosure and reporting requirements. Within the superannuation industry, there are significant disclosure and reporting requirements attaching to Australian Financial Services Licensees ("AFSL") and RSE Licensees *in addition to* the basic Corporations Act requirements. Superannuation Trustees are already operating at a high governance standard, regardless of whether the company is a proprietary or public one.

25. Trustee companies, as Australian Financial Services Licensees, are required to lodge various forms and evidence relating to its operation. ASIC are a robust regulator. In addition to ASIC, Trustee operations are also monitored by APRA from a prudential perspective. This system of two regulators, although not completely preferable, is adequate and creates a strong regulatory framework to keep members' benefits secure.

26. The joint regulatory environment creates a secure framework within which Trustee companies operate. Like the SIS Covenants, this framework works well as evidenced by no major collapses of regulated superannuation funds run by Trustee Companies.[6] This track record of the safety of superannuation is a testament to the current structure. Whilst an amalgamation of ASIC and APRA may be an appropriate future step which would have both cost and simplification benefits, the current regulatory framework is more than adequate.

27. As such, the added requirement that all Trustee companies be made public companies is unnecessary.

A "one size fits all" approach inadvisable

28. Not all superannuation funds or Trustee companies are the same. Different funds have different member demographics, structures, histories, benefits, systems and operations (not an exhaustive list). Given this, implementing a blanket approach which would try to make all Trustees the same and adhere to the same standards would be detrimental to the benefits that these differences bring to a diverse industry which provides different solutions to different members.

29. Not only that, a blanket requirement would only create unnecessary compliance and legal costs. It would impose additional complicated requirements on Trustees who already have significant compliance obligations as AFS Licensees, RSE Licensees and under both the

[6] The Ansett Staff Superannuation Fund is an exception to this, however, that scenario is distinguishable as the lack of ability to pay superannuation benefits resulted from the mismanagement of the employer-sponsor, who had not made the required contributions to fund the complicated defined benefit design of that particular fund.

Corporations Act and SIS. These additional compliance costs would be passed onto members.

29.1 Further, if this were to be implemented, would the public sector Government superannuation funds be required to become public companies? This would not be consistent with the framework within which they are created and administered – which is via an Act of Parliament (either State or Federal). This would also have constitutional law implications.

30. A change is this area of superannuation affects the major underpinnings of superannuation trust law and would have far reaching ramifications on the industry, requiring substantial restructuring and additional costs to members. A cost/benefit analysis to change this structure cannot be borne out. AIST strongly supports the current situation.

TERM OF REFERENCE 3 – THE RELEVANCE OF AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY STANDARDS [8]

RECOMMENDATION 3

AIST does not support any change to the existing APRA Operating Standards and believes that they are both appropriate and required for prudential management of superannuation funds.

Current Operating Standards

31. AIST believes that the existing APRA Operating Standards (prescribed within Part 3 of SIS and throughout the SIS Regulations) are appropriate and are necessary for the proper and prudential management of superannuation funds.

32. The RSE Licensing regime inserted a number of new Operating Standards into SIS and the SIS Regulations which provides for an increased level of risk management by superannuation Trustees, including monitoring fundamental business operations like outsourcing, maintaining adequacy of resources, Trustee directors' fitness and propriety, the creation and implementation of a detailed Risk Management Strategy and Risk Management Plan, and the $5 Million Net Tangible Asset requirements.

33. The range of Operating Standards set the framework within which a superannuation fund Trustee must operate its business and to set appropriate parameters and guidelines on such matters as how members can contribute to superannuation, gain access to superannuation, the payment and preservation of benefits and other operational matters of superannuation funds, including investments, solvency of Trustees, and the winding up of superannuation funds.

[8] AIST is unclear to which "standards" the Committee is referring to with this Term of Reference, however, has assumed that it is in reference to APRA's Operating Standards under SIS.

Maintaining the current Operating Standards

34. The current Operating Standards deal with the essential operation of superannuation funds from a governance and board perspective, as well from a member perspective.

35. These Operating Standards are more than adequate to ensure the good management of superannuation funds and to preserve members' superannuation benefits for retirement.

36. AIST believes that there are no compelling reasons to change such fundamental underpinnings of the superannuation system, as AIST members are rigorously enforcing the Operating Standards and will continue to do so. The Standards set a strong framework for the protection of members' superannuation.

TERM OF REFERENCE 4 – THE ROLE OF ADVICE IN SUPERANNUATION

RECOMMENDATION 4

AIST submits that:

i. there should be no commissions payable on Superannuation Guarantee contributions, voluntary contributions (either member or additional employer) or rollovers/roll-ins; and

ii. the fundamental conflict of interests experienced by financial product advisers receiving commissions or other incentives by recommending certain products instead of others should be addressed via legislative means.

This would alleviate the problems of lack of both impartiality and quality advice experienced by some consumers.

Prohibition of commissions on Superannuation Guarantee contributions, voluntary contributions (either member or additional employer) or rollovers/roll-ins

37. AIST firmly believes that there should be a clear prohibition on financial product advisers obtaining any type of commission (trailing, one-off or otherwise) on Superannuation Guarantee ("SG") contributions, voluntary contributions (either member or additional employer) or rollovers/roll-ins.

38. AIST submits that in particular, by using the following example of SG contributions, the payment of commissions on SG is shown to be illogical, unfair and unconscionable. This rationale is equally applicable to all forms of contributions made to superannuation and rollovers and roll-ins of superannuation.

39. SG contributions are made by employers on behalf of employees. It forms part of an employee's employment package, and it is a legislated amount of 9% of the employee's salary.

39.1 To allow a financial adviser or financial planner to reap a financial benefit via a trailing or one-off commission on an amount that must, by law, be paid into an employee's superannuation fund is unfair and unreasonable. (An adviser or sales agent does not have to work very hard to obtain funds that are legislated that an employee must receive.) Yet, the adviser or sales agent may be able to obtain a financial benefit from those contributions.

39.2 Combine this kind of financial benefit with the fact that ASIC research has indicated that financial advice is significantly lacking in quality due to conflicts of interest in recommending "in-house" products by many financial advisers, and it can indicate that consumers are often receiving flawed advice due to the commissions structure. For example, a common commission scenario involves the following:

39.2.1 An adviser or sales agent gets a trailing annual commission of 0.5% or 1% on an employee's 9% SG contribution. This annual commission could conceivably continue over a period of years, perhaps while ever that member stays in that recommended superannuation fund.

39.2.2 The adviser or sales agent may also receive a commission on recommending a particular superannuation fund over another.

39.2.3 If that adviser is faced with the choice of recommending a fund that will give him or her those sorts of commissions, over a fund which will not, there is a fundamental conflict for that financial adviser or sales agent.

39.2.4 As ASIC's research has shown, until commissions are removed entirely, how can a consumer judge whether the advice they are receiving is impartial and will actually suit them and their needs and circumstances, over the needs of the financial adviser or sales agent?

39.3 Further, AIST members have indicated that there is a preponderance of "advice" in the financial services market which is actually just "selling" by financial advisers, or sales agents. It's not "real" advice, as it doesn't take into the client's *full* financial circumstances and is, in fact, only providing a sales opportunity to an financial institution which may not have the client's best interests at heart.

40. A prohibition on this practice of generating commissions on SG contributions, voluntary contributions of any kind and rollovers/roll-ins will result in a greater net benefit to members for their retirement and will not erode SG contributions. Leading commentators have indicated that 9% of a person's salary may not be sufficient for all members to maintain a reasonable standard of living in retirement.

41. Permitting advisers to claim commissions on SG will only further erode a members' SG contributions and further detrimentally impact their retirement savings and future standards of living.

ASIC Report – "Shadow Shopping Survey on Superannuation Advice"

42. Research supports AIST's views that the fundamental conflicts of interest in relation to commissions and incentives for advisers have a negative impact on consumers. AIST was disturbed to read ASIC's Report "Shadow Shopping Survey on Superannuation Advice" released in April 2006 [9] and the previous reports, released in August 2005 [10], as well as the initial ASIC report on these issues, which was a joint undertaking with the Australian Consumers Association, "Survey on the Quality of Financial Planning Advice" released in February 2003 [11]. The 2006 report "*found the financial advice industry still has significant work to do before the quality of advice will be consistently at a level that ASIC and consumers would regard as acceptable*." [12]

43. In summary, the ASIC Shadow Shopping identified:

- that of 306 participants in the survey, 16% of advice was clearly not reasonable, given the client's needs and that a further 3% was probably not reasonable;
- a third of the advice given to consumers to switch funds lacked credible reasons and risked leaving the consumer worse off;
- unreasonable advice was 3-6 times more common where the adviser had an actual conflict of interest over remuneration (eg receiving commissions from a recommendation for a product) or recommending associated products;
- consumers were rarely able to detect bad advice;
- in 46% of cases, advisers failed to give a written Statement of Advice where one was required.[13]

44. Of real concern to AIST was ASIC's finding that 85% of consumers felt satisfied with poor advice given to them, including cases where if they followed the advice, they would likely to be left worse off in retirement. This indicates that consumers are not in the position to judge whether advice is flawed, tainted or conflicted or that the adviser would stand to benefit financially if the consumer followed the advice. As ASIC itself stated, "*While some progress has been made, the cultural changes mandated by the Financial Services Reform Act are not happening quickly enough.*"

    44.1 While ever commissions are permitted in general, and specifically on SG contributions, consumers are subjected to conflicted and

[9] The ASIC Shadow Shopping Survey on Superannuation Advice report can be downloaded at: http://www.asic.gov.au/asic/asic.nsf/lkuppdf/ASIC+PDFW?opendocument&key=shadow_shop_report_2006_pdf

[10] ASIC report, "Superannuation Switching Surveillance" can be downloaded at: http://www.asic.gov.au/asic/asic.nsf/lkuppdf/ASIC+PDFW?opendocument&key=Super_switching_report_pdf

[11] The ASIC report can be downloaded at: http://www.asic.gov.au/asic/asic.nsf/lkuppdf/ASIC+PDFW?opendocument&key=Advice_Report_pdf

[12] Ibid, Page 2

[13] ASIC Shadow Shopping Survey on Superannuation Advice report, Page 2

potentially flawed financial advice. This is supported by ASIC's Shadow Shopping, and the recent Enforceable Undertaking obtained by ASIC from AMP Financial Planning Pty Limited. (Discussed below.)

AMP Enforceable Undertaking

45. On 27 July 2006, ASIC obtained an Enforceable Undertaking from AMP Financial Planning Pty Limited ("AMP") in relation to poor advice provided by randomly selected AMP financial planners who are authorised representatives of AMP.

46. This Enforceable Undertaking states that:

    - *"in ASIC's review of files relating to superannuation switching advice, ASIC formed the view that disclosure of a reasonable basis for advice was inadequate in approximately 45% of files reviewed."*
    - Along with this, Statements of Advice provided to clients by AMP planners were inadequate (in particular with references made to the trailing commissions payable to the AMP financial planner); and
    - ASIC was also concerned that 93% of all new investment or superannuation business resulting from advice from an AMP financial planner was invested in AMP products or platforms. *"This is not atypical of dealer groups like AMP."* [14]

47. As a result of ASIC's Shadow Shopping Survey, ASIC has indicated that it will conduct follow up action for 14 Australian Financial Services Licensees. AIST would not be surprised if more Enforceable Undertakings are reached as a result of these investigations.

48. AIST thought it was interesting that MLC and ANZ Bank have both recently announced its decision to remove commissions payable to its sale staff, noting the fundamental conflict of interests involved in the commissions model.

Conflicts of Interest Legislative Provisions

49. Under Section 912A(1)(aa) of the *Corporations Act*, a financial services licensee must have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative.

50. In addition, ASIC have released Policy Statement 181, which outlines its general approach on managing conflicts of interest, guidelines on controlling, avoiding and disclosing conflicts.

Fundamental conflicts of interest in some licensees

51. The current advice framework is fundamentally flawed due to the actual and perceived conflicts of interest due to the commissions paid to advisers and that the financial advisers are tied to particular organisations, which as ASIC's investigations show, engenders advisers to

[14] Enforceable Undertaking between ASIC & AMP Financial Planning Pty Limited, dated 27 July 2006, Page 6

recommend their own in-house products, over those not within their commission-based structure.

52. Until these flaws which underpin a commission-based model are removed, consumer confidence will be low in financial advisers, and the industry in general, consumer's retirement savings will be eroded, financial advice will be inadequate.

53. This is a moral issue, as well as a legal one. There are other methods for remunerating financial advisers which will not generate this conflict of interest and that is by way of a "fee for service" for the advice by advisers who are paid via a salary, not commissions.

54. Further in relation to ASIC's report, it found that advice that was non-compliant was about **6 times** more common where the adviser had an actual conflict of interest over remuneration. Where the adviser had a conflict over remuneration, 28% of the advice clearly did not have a reasonable basis for advice. When ASIC used the figures to determine how this would affect a consumer's retirement savings, the calculator projected that consumers would be worse off at retirement based on the advice provided.

    54.1 Clearly these procedures are inadequate and flawed like the advice itself.

    54.2 It is encouraging that the Financial Planning Association has recently adopted four principles relating to conflicts of interest which apply from 1 July 2006 (which has a transitional period). Under these principles, planners must identify their advice fee separately in the Statement of Advice and disclose total fees for ongoing advice on a regular basis.

        54.2.1 These principles are insufficient alone, as without legislation to back up these principles they are optional rather than mandatory.

'Lifetime of Difference' where no commissions are paid

55. This is a moral issue, as well as a legal one. There are other methods for remunerating financial advisers which will not generate this conflict of interest and that is by way of a "fee for service" for the advice by advisers who are paid via a salary, not commissions.

56. On the issue of how commissions reduce retirement benefits, this has been established through independent research conducted by SuperRatings, a leading assessment body for the superannuation industry. (AIST acknowledges that commissions are not the only reason why retirement benefits are higher in industry funds.[15]) SuperRatings concluded that over a 40 year working life, Australians could be more than 28% better off in an industry super fund, based on existing fee structures. (Especially where fees are being paid to advisers)This is equivalent to having $143,906 more (in today's dollars) or $386,397 more

[15] Research has indicated that industry funds return a higher retirement benefit to members than retail or commercial master trusts over rolling one, three and five year periods. The level of fees, the investment returns due to strategic asset allocation, whether profits are returned to shareholders and other related matters, as well as commissions, all have an impact on why industry funds out perform retail funds and master trusts.

(in future dollars) in their superannuation account at retirement. Over a typical working lifetime, this difference can greatly affect the lifestyle an average Australian can lead in his or her retirement[16].

TERMS OF REFERENCE 5 & 6 – THE MEANING OF MEMBER INVESTMENT CHOICE & THE RESPONSIBILITY OF THE TRUSTEE IN A MEMBER INVESTMENT CHOICE SITUATION [17]

RECOMMENDATIONS 5 & 6

AIST does not support any change to the existing member investment choice framework OR any changes to a Trustee's responsibility in a member investment choice situation, as it is sufficiently covered by the *Superannuation Industry (Supervision) Act* 1993 and by the existing fiduciary obligations of a Trustee in terms of developing its Investment Strategies and asset allocations.

Definition of member investment choice

57. One definition of "member investment choice" is the ability of a member of a superannuation fund to select various investment options or strategies pre-determined and offered by the Trustee into which their superannuation contributions are to be invested. Depending on the structure of the fund, members may be able to diversify their investment portfolio across a range of assets and investment vehicles.

Investment management generally in Trustee companies

58. The area of Trustee investment strategies and member investment choice is highly regulated under SIS and its Regulations. It is of note that APRA recently released a new Superannuation Circular on Managing Investments and Investment Choice, to which AIST refers the Committee.[18]

    58.1 Under SIS, a Trustee is permitted to obtain advice from "experts" or other service providers to engage other persons to do "acts or things on behalf of the Trustee", including assistance in relation to the formulation of an investment strategy. Given the unique

[16] **PLEASE NOTE** - the comparisons referred to above show projected outcomes, applying today's average fees of Industry Super Funds and Retail Master Trusts, over 35 years. Note that differences in fees may change in the future, which would alter the actual outcome. Comparisons were modelled by industry experts SuperRatings (commissioned by Industry Fund Services) using average fees for 19 Industry Super Funds and 19 Retail Master Trusts as at 31 March 2006. The above example is a comparison of two workers that assumes: same inflation, same investment returns, same age of 30, same retirement age of 65, same starting balance of $50,000, same income of $50,000 and same 9% superannuation guarantee contributions. Please refer to www.industrysuper.com for more information.

[17] AIST is combining Terms of Reference 5 & 6 due to the related nature of these Terms and to avoid duplication.

[18] Superannuation Circular No. II.D.1 – *Managing Investments and Investment Choice*, March 2006.

"equal representation" rules of superannuation funds,[19] there is room for the argument that a Trustee is obliged to obtain outside assistance in formulating its investment strategies based on expert advice.

58.1.1 It should be noted, however, that also under SIS, the Trustee must remain solely responsible and directly accountable for the prudential management of the investment of the Trustee's assets. Even though the Trustee may "outsource" or delegate the management of its investments, it will retain all responsibility in relation to it, in accordance with delegation and agency laws.

58.2 Most Trustee Companies engage an Asset Consultant, Investment Consultants, and/or a Master Custodian to provide professional advice to the Trustee regarding investments in the Fund.

58.3 In addition, Trustees are required to have in place detailed written agreements with each of its Investment Managers who hold mandates in relation to the investment of assets. These mandates and agreements are monitored by the Trustee's Custodian and Asset or Investment Consultants, who in turn, provide advice to the Trustee on investment matters. Often, a Trustee Board will have a designated Investment sub-Committee who are responsible for the carriage of the applicable investment decisions (which are then endorsed at Board level) and further, in-house specialist investment staff to manage the day to day investment operations.

58.4 It is generally a highly sophisticated and very well regulated part of a well-run Trustee company.

58.5 It is important to note that there are some Trustees who do not offer any investment choice to its members. This is a decision that must be made at the Trustee level.

Current investment-related law for superannuation Trustees

59. Under the SIS Covenants, a Trustee is required to "formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the Trustee entity, including (summarised):

- the risk and return involved in investments, having regard to its objectives and cash flow requirements;
- composition of entity's investments as a whole, including the extent to which the investments are diverse or involve risks of inadequate diversification;
- the liquidity of the entity's investments having regarding to expected cash flow requirements; and
- the ability of the Trustee entity to discharge its existing and prospective liabilities. [20]

[19] Equal Representation refers to the requirement that a trustee board of an employer-sponsored fund with five or more members must have equal numbers of member representatives and employer representatives acting as trustees (if there are individual trustees) or directors (if there is a corporate trustee) or policy committee members.

[20] Subsection 52(2)(f) SIS.

59.1 Further, the development of an Investment Strategy is also named as an "operating standard" under the SIS Regulations and therefore has more weight at law.[21]

59.2 Although generally a Trustee cannot be bound by a direction from a member[22], SIS provides an exception to this general principle where a Trustee can accept directions from a member in relation to the investment strategy it has determined, if it is in accordance with the SIS Regulations.

60. As mentioned above, the SIS Regulations provide additional requirements on the Trustee in relation to member investment choice when a Trustee decides to give members investment choice.[23] (It should be noted here that some Trustees do not provide member investment choice to their members, and that current superannuation law does not require a Trustee to do so.) These Regulations provide that (in summary):

- A Trustee must provide two or more investment strategies from which a member can choose (either choosing one strategy or a combination of strategies); and
- A Trustee must also give a member the investment objectives of each investment strategy and "all information the Trustee reasonably believes a person would reasonably need for the purpose of understanding the effect of, and any risk involved in, each of those strategies"; and
- That the member is fully informed of the range of directions that can be given and the circumstances in which they can be changed; and
- The direction from the member regarding investment choice specifies which strategy or combination of strategies is to be followed and any matters referred to in that choice.

61. Further to the above legislation, it should be noted that there are additional requirements under SIS and the SIS Regulations (including the Outsourcing Operating Standard) which outline a number of other areas which must be contained in an Investment Management Agreement. Without these numerous requirements, the Agreement will not be valid. This is yet another safeguard in relation to investments.

Revised APRA circular on managing investments and investment choice

62. The APRA Circular (previously referred to) states that the underlying policy intent of the above legislation 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.

62.1 This means that even if Trustees still accept a member direction, the Trustee, among other things, is not relieved of its duties to ensure a reasonably liquid and diversified fund.

[21] Regulation 4.09 of SIS Regulations

[22] Subsection 58(2) SIS.

[23] Regulation 4.02 of SIS Regulations.

62.2 Further to the need to develop an investment strategy, Trustee Companies are encouraged (expressed as an APRA "expectation") to consider a number a fundamental investment principles:

- The fund's circumstances – including the membership profile, for example, its members' ages and expectations, occupational profile etc, benefit structure, portability and choice of fund, fund "phase" (i.e. – accumulation phase, withdrawal phase etc), whether investment choice is offered to members, tax position, fund size etc;
- Diversification investment principles;
- Risk and return;
- Liquidity and cash flow requirements;
- Investment choice for members; and
- "other desirable considerations for Trustees" – for example, advice about particular investment strategies, documenting Trustee consideration of an investment strategy, asset allocation ranges, and investment strategy defences;

62.3 Additionally, where the Trustee intends on offering investment choice to members, applying those same principles to that investment choice; and

62.4 The consideration of conflicts of interest which may occur when implementing an investment strategy.

AIST's position on managing investments and investment choice

63. AIST does not believe that there are any compelling reasons to change the current framework relating to member investment choice or the responsibility of the Trustee in a member investment choice situation. The current framework detailed below is considered to be adequate, appropriate and practical for Trustees to implement where applicable.

63.1 The Trustee, in formulating an Investment Strategy, obtains professional advice from numerous investment advisers, including its Custodian, Asset Consultants, Investment Advisers, Investment Managers and other specialist in-house advisers, which will be considered by the Trustee at a Board Meeting (or specialist sub-Committee of the Board);

63.2 The Trustee will then formulate and implement a Investment Strategy/Strategies against both the SIS and APRA Circular criteria detailed above, including asset allocations, based on the above professional investment advice;

63.3 The Trustee, in its Product Disclosure Statement ("PDS"), sets out its Investment Strategies, asset allocations, past performance, and all other relevant disclosure details about the investments, in easy to understand language for members to read and consider their investments options.

63.3.1 The Trustee will also determine which investment option would be the best for a member who decides *not* to make a choice about their investments, or who fails to do so and this investment choice is known in most superannuation funds as the "default" investment option, which most often is a the "balanced" investment option (often a "middle of the road" investment strategy);

63.3.2 The Trustee, among other things, will also have to determine whether a member can change his or her investment choice, how often and what fee, if any, should be charged upon doing so;

63.4 The members of superannuation funds, where applicable, are then able to select which investment option they would like their superannuation invested in, based on their reading of the PDS, asking questions of their superannuation fund, their own view of their risk profile, and what they think would be suitable for their superannuation investments.

64. AIST believes that it is up to funds to offer a range of appropriate choices within which members may choose their individual investment options. The Trustee has a fiduciary duty to ensure that it considers all of the background factors in developing its investment strategies and that they are appropriate for the Fund.

64.1 Additionally, Trustees have an important role in developing appropriate communication material that their members can readily understand to assist in comparing the different strategies that are available to them.

64.2 On this point, AIST believes that should a Trustee offer investment choice to its members, a Trustee is entitled to rely on a member's investment choice at face value. A Trustee should not be required to go behind that member instruction and consider whether it was appropriate or not for that member.

Members and investment choice

65. Research from AIST members has indicated that those superannuation funds who do offer investment choice to members, have a large proportion of members who do not exercise their investment choice options and are therefore placed in the "default" or "balanced" investment option until the member chooses to change investment options (if at all). This indicates either that there is a lack of engagement by members in relation to investment options, or that they are happy with the default option selected by Funds.

66. Further, international anecdotal evidence reported to AIST regarding investment choice indicates that there are dangers in providing choice to investors where the investor does not have the education or resources behind them to make a truly *informed* choice. In particular, investors can make poor immediate choices which are not in their long term best interests, but as they are not entirely sure of the ramifications, may choose an investment strategy which may not be appropriate.

66.1 Therefore, the current situation in relation to investment choice is appropriate in the Australian context. That is, Trustees are able to set investment strategies and a default strategy, based on expert advice which is in members' best interests, and members may be able to elect the investment options into which they may place their superannuation.

TERM OF REFERENCE 7 – THE REASONS FOR THE GROWTH IN SELF MANAGED SUPERANNUATION FUNDS

RECOMMENDATION 7

AIST submits that there should be further regulation for the Self-Managed Superannuation Fund sector, particularly with reference to when and how a financial product adviser (or other "professional") is permitted to recommend a Self-Managed Superannuation Fund.

Self-Managed Superannuation Funds ("SMSFs") according to the SMSF Professionals' Association of Australia Limited

67. The SMSF Professionals' Association of Australia state that more than $180 billion worth of assets reside in Australia's SMSFs or approximately 24% of the total superannuation pool of assets. Further, that since 1994, the SMSF industry has grown at a compound rate of 25% each year. Approximately 2,000 new SMSFs are set up every month with the current average member balance standing at $290,000.

SMSF advice is under-regulated & a risk to consumers

68. AIST is concerned with SMSFs in general as it is an under-regulated sector of the superannuation system.

69. Of particular concern to AIST is that there is no formal requirement to be a licensed SMSF adviser, and as such, there has been a dramatic expansion in the number of people – both professionals and non-professionals – providing advice and recommending SMSFs to clients. The SMSF Professionals' Association of Australia appears to also be concerned with this growth, as it means any person may claim to be an SMSF adviser, irrespective of whether they have had any formal training in the field.[24]

70. This is an area which is ripe for review and further regulation, as the potential to mislead and deceive members of the public about the benefits of SMSFs is extremely high.

71. In addition, in such an under-regulated environment, the high operational and legal and compliance costs involved in running a SMSF, the risks involved in managing one's own investments, the ongoing involvement and management which is required and the large sums of

[24] http://www.spaa.asn.au/ - this information can be found under the "Our Role" section of the SPAA Website.

capital needed to make a SMSF viable all contribute to need for further reform and regulation.

71.1 Regulation in this area should aim to ensure that members' interests are protected and that persons who are providing advice about SMSFs (who include, but not limited to, accountants, auditors, financial planners, lawyers, risk providers, actuaries, administrators and educators) are not profiting from members who are not well informed about the nature, risks and peculiarities of SMSFs and whether they are appropriate for the individual member.

SMSFs generally

72. There is a general perception that SMSFs are "do-it-yourself" superannuation funds. In some ways they are, however, there appears to be a general perception that SMSFs do not have the type of compliance obligations that regulated superannuation funds have. This is incorrect and has led to significant compliance breaches which are constantly being managed by the ATO.

73. The ATO has quite publicly set out areas of problems with compliance for many SMSFs and often remind SMSF Trustees that they are still required to comply with major superannuation trust features such as:

- Director duties and covenants under SIS and Directors' fiduciary obligations;
- Trustees must keep money and other assets of their fund separate from their own money;
- Trustees are also prohibited from using money belonging to the fund for personal or business purposes or as a form of credit when faced with such a need;
- Loans must not be made to related parties at non-commercial rates. A fund may loan money to a related party who is not a relative of a member, provided the transaction satisfies the arm's length provisions of SIS and is repaid on commercial terms including a commercial rate of interest;
- The In-house Asset Rule stipulates investments, leases or loans to a related party are restricted to a maximum of 5% of the fund's total assets;
- SMSFs are restricted in the investments they can make to help ensure that the assets of the fund will be available to provide retirement income;
- That the acquisition of assets from a related party of the fund are prohibited except in limited cases;
- The requirement to have an independent auditor who conducts an annual audit of the fund and assists in compliance issues, and who is compelled by law to report breaches to the ATO;
- A worrying trend relating to SMSFs are schemes which promote the use of SMSFs to gain improper early access to preserved benefits, prompting the ATO to release a paper to SMSF Trustees entitled, "It's

Your Money, But Not Yet!" to reinforce the fact that SMSFs Trustees are not permitted to roll over their superannuation into an SMSF to help them illegally gain access to it.

74. The ATO has recently informed the industry that in its 2006-2007 compliance priorities will involve monitoring and helping Trustees of SMSFs and would continue to take a particular look at schemes promoting early access to superannuation – something that had been a concern for several years.

AIST's position on SMSFs

75. AIST acknowledges and is concerned by the fact that there are a significant number of SMSFs established each year, especially as the quality of advice obtained to establish a SMSF is variable. Financial advisers, accountants and lawyers, as well as others who may not be entirely qualified to give such advice, appear to be inappropriately advising clients to set up an SMSF.

    75.1 AIST is also concerned with the reported cases of SMSFs being set up with $10,000 or $50,000 to invest. SMSFs have a place in the superannuation industry, however, only if the member has over $200,000[25] to invest in an SMSF, is fully aware of all of the ongoing compliance and other costs involved in SMSFs, the risks and full details of any commissions payable on the SMSF and to whom and when.

    75.2 AIST's real concerns with SMSFs involve the way some SMSFs appear to be marketed and that they may not be appropriate for everyone. Combine this with the lack of consistent qualifications and that commissions may be payable to those recommending that a SMSF be set up, and it is a fundamentally flawed system which leaves those members vulnerable to miss-selling and misrepresentation.

76. The recent 'Westpoint' Investment scandal has shown the industry why it is essential to have further regulations in relation to the advice given to set up a SMSF. Over 4000 investors have lost a collective $300 million dollars as a result of the collapse. It's notable that the financial advisers giving the advice to the investors to put their life savings into Westpoint received a reported 10-20% commission on any investments made.

    76.1 In general terms, some investors in Westpoint were advised by various financial advisers to borrow money to set up an SMSF, roll in their current superannuation, the equity they had in their mortgage on their family home also went into the SMSF, as well as any savings they had. These SMSFs then invested into the Westpoint structure, never to be seen again. Due to the nature of SMSFs and the ability to place superannuation and other assets into them, those investors have lost everything – their homes, their superannuation and all their savings.

[25] This figure is also recommended by ASIC in its "Super Choices. Think about your Future" Booklet, April 2005, page 27.

76.2 Regulations must be introduced to prevent a recurrence of another Westpoint incident, and also to control the way SMSFs can be recommended to clients.

77. SMSFs have a place in the superannuation system, however, they will not be appropriate for the vast majority of Australians who currently have superannuation. AIST believes that there are some fundamental compliance problems with SMSFs, where they are being abused by unscrupulous Trustees and advisers, who receive a financial incentive to recommend SMSFs. (Either through a commission environment or the fact that the SMSF Directors will require ongoing professional services to run the SMSF, thus creating guaranteed return work for the advisers recommending the SMSF.)

78. There is a clear need for further regulation in this area of superannuation particularly with reference to when and how a financial product adviser (or other "professional" or "non-professional") is permitted to recommend an SMSF for a client.

78.1 Further, AIST submits that there is a need for additional regulation which requires clients to legally indicate that:

- they have been advised, understand and agree to setting up a SMSF;
- they were advised it was the most appropriate superannuation product for their circumstances; and
- that they understand all of the actual costs (in a dollar sense, not a percentage or estimation), liabilities, ongoing compliance costs (including accountants, investment advisers, lawyers etc), the investment choices applicable to them, the legalities and any other costs, and most importantly the fees which will be applicable on the SMSF and who will receive those fees and when.

78.2 AIST believes that there is a need for a much more regulated and transparent framework involved in SMSF creations, and persons who can provide advice on SMSFs.

79. In addition, the fact that SMSFs are regulated by the ATO, rather than ASIC or APRA results in an inconsistency of regulation, compared with the rest of the industry. The ATO, as regulator of SMSFs, arguably has its focus on revenue raising through taxation – its focus is not entirely on consumer protection or prudential management.

TERM OF REFERENCE 8 – THE DEMISE OF DEFINED BENEFIT FUNDS AND THE USE OF ACCUMULATION FUNDS AS THE INDUSTRY STANDARD FUND

RECOMMENDATION 8

AIST submits that whilst defined benefit funds have a significant role to play in the superannuation system of Australia, accumulation funds are more common and can offer members an accurate representation of their expected retirement benefits, provide portability and flexibility which is relevant to today's employment practices, and provides employers with certainties as to costs of superannuation.

Members of AIST from Defined Benefit Funds ("DB Funds")

80. AIST has many members who are Trustee Directors of DB Funds. AIST believes that DB Funds still have an important and significant role to play in Australia's superannuation system and that they provide excellent retirement benefits to their members. AIST believes that in some sectors of the workforce, DB funds are appropriate vehicles for retirement benefits and therefore should be retained for those sectors.

Definition of defined benefit funds

81. A DB Fund is a now less common superannuation fund where the formula for calculating the retirement benefit (and generally other benefits also) is specified in terms of years of service with the employer (or years of membership of the fund) and average salary level over the last few years prior to retirement.

    81.1 For example, the formula may be that a retiring member will receive 12 per cent of final average salary for each year of membership or a "multiple" which is based on length of service with the employer, which is then multiplied by the member's final average salary. The formulas can vary substantially depending upon fund design.

    81.2 Employers' costs under a DB Fund arrangement are never certain. This is because the employer-sponsor of a DB fund carries the investment risk (the defined benefits that the members of the fund receive do not depend on the investment performance of the fund, like an accumulation fund). Therefore, if investment returns are low, the employer may need to increase its contributions to enable the fund to meet its required benefit payments when they fall due.

Changing employment practices impacting on defined benefit funds

82. The demise of DB Funds can, in part, be traced back to the changes in employment practices. DB Funds are designed in a way that rewards members for staying with one employer for a long length of time (for

example, 10-30 years) – as a DB Fund member's benefit is dependent upon their length of service – the longer the service, the larger the retirement benefit. DB Funds are predicated on employees staying with the same employer for the length of their working life.

82.1 DB Funds were often designed for Executives and Management of employer-sponsored superannuation funds. It was often included as part of an employee's employment package and was an added bonus for being employed by that company. In 1993, Superannuation Guarantee was introduced, which made it compulsory for many employers to pay superannuation to employees. Therefore, superannuation was not just limited to Executives and Management of certain companies. This created administrative issues for employers who had to decide which employees received a DB Fund contribution and which received the legislated superannuation contribution.

82.2 Further, given the high casualisation of the workforce and the regular change in jobs by workers, as well as "Generation X" joining the workforce (and their predilection for changing employment frequently), the fact is that employees are not remaining in jobs for even 5 years, let alone 10 years, making the requirement to stay in employment to receive a higher superannuation benefit less attractive.

83. Additionally, DB Funds are traditionally less portable than accumulation funds. Generally, to remain an active member of a DB Fund, employees were required to remain in the employment of the associated employer sponsor. In some instances, members would be required to roll their benefits out of a DB Fund upon ceasing employment with the employer-sponsor. Archaic rules under some DB Fund Trust Deeds could result in those employees receiving nothing but their own contributions into the fund (which they were required to make), but no interest and none of the employer contributions – resulting in them losing all superannuation benefits accrued during their time with that employer.[26] This kind of inequity has been addressed with accumulation style funds, where the SG contribution, or the member contribution, vests immediately with the member and is not then a benefit that an employer can receive upon the employee ceasing employment.

Uncertainties of costs for employers

84. Under the DB Fund arrangement, an employer has less certainties about their contributions to superannuation. At the end of each year, or at other times during a year, an actuary will conduct a review of the DB Fund to determine how much the employer is required to contribute to be able to pay out its members' benefits when they fall due. Depending upon members joining and leaving the DB Fund, the incidence of retirement, disablement or death within the Fund's membership, and other factors like investment returns, the amount the employer is required to contribute can vary from year to year.

[26] This kind of situation is prohibition under the current superannuation laws, due to the "minimum benefit" requirements introduced in SIS.

84.1 Also, under some DB Funds, pensions are payable to members, their spouses and sometimes their children. Pensions can be payable for life, under some DB Funds, and for the lives of members' spouses, and up until age 18 for the children, or until they cease full time employment. These types of liabilities can create ongoing large liabilities for employers, which are difficult to predict and costly to maintain. In some DB Funds, like unfunded Public Sector funds (Government funds), these unfunded liabilities cannot be resolved for decades.

AIST's position on accumulation funds as the industry standard

85. AIST submits that accumulation funds offer members an accurate representation of their expected retirement benefits, provide portability and flexibility which is relevant to today's employment practices, and provides employers with certainties as to their superannuation costs.

86. AIST submits that the one downfall with accumulation style funds is that the legislated 9% SG contribution will not be enough to sustain most retirees in a reasonable standard of living in retirement. Research indicates that approximately 15% is more the amount members should be aiming for when making voluntary contributions. AIST believes that for all the benefits of accumulation style funds, members should be encouraged to voluntarily contribute at least an extra 6% on top of the legislated 9% to ensure adequacy of superannuation in retirement.

87. Incentives to encourage extra voluntary contributions would be welcomed by AIST.

TERM OF REFERENCE 9 – COST OF COMPLIANCE

RECOMMENDATION 9

AIST submits that the cost of compliance on superannuation Trustees covers all aspects of a Trustee's operations and involves both direct and indirect costs to continue to comply with such significant and wide ranging pieces of legislation which affect superannuation fund Trustees.

Compliance costs resulting from legislation

88. A superannuation fund trustee must comply with legislation administered by APRA, ASIC, the ATO (soon also to include the AUSTRAC when the anti-money laundering and counter terrorism laws come into effect) which affects the day to day running of a superannuation fund. In addition to this, a Trustee must also comply with general trust law principles, natural justice and procedural fairness principles, and innumerable other State and Federal pieces of legislation.

88.1 To manage the ongoing numerous and often complicated compliance obligations under these pieces of legislation, a Trustee can either have an in-house compliance manager or

lawyer on staff, can engage external compliance and legal professionals, or a combination of both. The combination of using both in-house expertise and external lawyers or consultants for projects or other tasks is a common method for managing time, legal liability and costs.

89. Apart from compliance with the complicated pieces of legislation which affect superannuation Trustees, there are also APRA Circulars and Guidance Notes, ASIC Policy Statements, Class Orders, Information Releases, FAQs, ASIC and APRA form lodgements, SCT Guidance Papers, ATO Determinations and Rulings, judgements from applicable courts and other tribunals on issues which affect superannuation and other publications which must be located, read, understood, implemented at the Fund level, provision of training for relevant staff, correction of any member disclosure documents, updating of the website and in-house staff technical manuals.

Compliance costs resulting from in-house staff and external legal and compliance consultants to ensure ongoing compliance with legislation

90. The cost of employing in-house compliance professionals can be quite high for superannuation fund Trustees, as it is a highly specialised and competitive employment market. In-house specialist compliance and legal employees (many compliance professionals are also qualified lawyers) attract high salaries, and then there are also the additional "on-costs" relating to the employment of staff. The fact that there is a compliance professional shortage adds to these costs, as demand exceeds supply.

    90.1 It should be noted that some of the smaller superannuation funds outsource their compliance function to an external consultant, which can often result in higher costs to the fund, less access to the compliance consultant, more time to have compliance issues addressed and a potential lack of responsiveness to compliance issues, including breaches, which often have tight deadlines for reporting to the regulators.

91. In addition, other (and quite large) compliance costs come from the need to engage external lawyers or other professionals to "translate" or provide summaries in relation to the legislation, to provide consulting tasks or projects for ad-hoc advice, and to provide legal and compliance sign off in relation to Trustee documentation, letters, communication to members, internal technical manuals, correspondence with regulators, lodgement of forms with regulators, advice in relation to interpretation of trust deeds or articles of association, advice regarding regulator action taken against a Trustee and so on.

92. Further large compliance costs are in the area of taxation law and practice compliance. The taxation laws applicable to superannuation exist at many levels of superannuation – for example, upon entry and exit of the members' contributions, on the earnings of the fund, in the accounting and financial aspects of the fund, the company taxation requirements, capital gains tax, goods and services tax, surcharge taxes

on member benefits and the taxation components on "eligible termination payments", to name a few.

93. The risks of non-compliance to a Fund which does not have an in-house compliance staff member, or access to external compliance professionals, can have catastrophic impacts on a superannuation fund (please note, these are a few limited examples):

- it could mean the loss of either or both of the two licenses held by the Trustee (the Australian Financial Services Licence administered by ASIC or the Registrable Superannuation Entity Licence administered by APRA). The practical and reputation impact of such a loss of Licence by a Trustee would have a long term negative impact on the viability of the Fund in such a competitive superannuation fund environment;
- breach reporting within the statutory time frames may be compromised (timely breach reporting are conditions of both RSE & AFS Licences);
- ongoing monitoring of service providers would be more limited;
- the risks involved in not signing off Trustee and Fund documentation could result in a breach of a licence condition and/or opening the Trustee up to a potential claim of misleading and deceptive conduct; or
- a failure of the Trustee to be kept up to date on various technical, industry or legislative changes in a timely manner.

Inequities in the costs of compliance

94. The costs of compliance can run to hundreds of thousands of dollars per year for most Funds. Various superannuation funds reported that the cost of obtaining their APRA RSE Licence was in the vicinity of $500,000 to $1 Million dollars.

94.1 These estimations do not seem unreasonable when considering the following example: one large industry superannuation fund employed an in-house lawyer in a senior compliance role for 12 months, who spent 90% of their time on preparation work for the RSE Licence Application. That employee was supervised by a Compliance Manager who spent 70% of their time on the RSE Application. On top of those in-house costs, external lawyers were engaged to review various documents and contracts and provide specialist advice relating to the operations of that super Trustee.

94.2 When considering the annual costs for the staffs' salaries and other employment costs, along with the external legal fees for review of Investment Management Agreements and other contracts and documents, auditor review of the Fund's Risk Management Strategy and Plan, the costs of ongoing general compliance and risk monitoring, and the other professional services required to be engaged during the RSE Licence application, it appears that $1 Million compliance costs are somewhat conservative.

95. The ongoing nature of these compliance costs and the fact that they are both unavoidable and necessary costs due to the extreme complexity in most pieces of legislation affecting superannuation, means that in order to continue to comply with superannuation law, a Trustee must spend hundreds of thousands of dollars each year, in order to continue to survive and operate within the legislative framework.

96. AIST submits that these costs of compliance are already very high and should not be increased further. Whilst the costs of compliance are understandable, they have been quite detrimental to some superannuation funds, as the large and ongoing nature of compliance costs have contributed to fund closures and mergers, particularly due to RSE Licensing.

97. These compliance costs affect every superannuation fund regardless of size. The large funds have these compliance costs, but the small funds do too – many of the same unavoidable costs including legal sign off and day to day compliance monitoring. The smaller superannuation fund may not have significantly reduced compliance costs when compared with the larger funds, as compliance costs tend to affect all funds fairly equally.

    97.1 For example, the cost involved in having a small superannuation fund's Product Disclosure Statement ("PDS") compliance checked and legally signed off will cost roughly the same as a large superannuation fund, but the larger fund may obtain discounts in relation to the amount of printing of the PDS, compared to the smaller fund. The cost of compliance is inequitable when considering that checking just one PDS is a small part of compliance costs overall.

Further changes to superannuation will only increase compliance costs

98. The superannuation industry is resigned to the fact that it has been, and is, susceptible to continual change, due to the very nature of the superannuation and tax laws. Whilst these changes may enthuse superannuation lawyers and compliance professionals due to their continued marketability, members of superannuation funds are puzzled by the continued changes to a regime that is complicated, confusing and out of their reach until they retire.

    98.1 Further complicated changes will also hinder the ability of superannuation Trustees to educate their members on even the very basics of superannuation. If the laws keep changing, it's very difficult to keep members fully informed and engaged with their super. Members will continue to lose faith in the integrity of the system. This is a non-financial cost of compliance.

99. AIST is concerned that an inquiry of this nature into the very framework of the superannuation system could result in fundamental change to the way superannuation is operated in Australia. Unnecessary changes will only increase compliance costs, further disengage members on their retirement and make the superannuation system more difficult for superannuation Trustees to manage and operate successfully. The goal of this inquiry should be to simplify the system, not make it more complicated.

TERM OF REFERENCE 10 – THE APPROPRIATENESS OF THE FUNDING ARRANGEMENTS FOR PRUDENTIAL REGULATION

RECOMMENDATION 10

AIST submits that the current method of funding for prudential regulation is adequate, equitable, and transparent.

Current Funding arrangements for prudential regulation

100. Under the *Superannuation Supervisory Levy Imposition Act* 1998, a levy is collected from various financial sector organisations, including superannuation Trustees. These financial sector levies are set with the intention of covering the operational costs of the Australian Prudential Regulation Authority (APRA), and certain market integrity and consumer protection functions undertaken by the Australian Securities and Investments Commission (ASIC) and the Australian Taxation Office (ATO). The relevant ASIC costs include the operations of the Superannuation Complaints Tribunal. These levy-setting arrangements were established following the Government's consideration of the recommendations of the 1997 Financial System Inquiry (Wallis Inquiry)[27].

101. This levy is determined by the Minister for Revenue and Assistant Treasurer after industry consultation with various representative bodies. The determined sum represents the minimum and maximum amounts for the levy and the rate (as a percentage of reported assets or balances) to be applied.

102. The estimated funding of superannuation supervision for 2006-07 is $46.2 million (43.9 per cent of the total levy), comprising $34.2 million for APRA funding, $8.2 million in costs relating to work undertaken by ASIC and $3.8 million in costs relating to work undertaken by the ATO. This compares to the $43.4 million (or 43.1 per cent) in 2005-06. These are quite high costs to the industry.

How the Levy is determined

103. The levy is intended essentially to raise sufficient revenue to meet the budgeted costs of supervising that sector for that financial year. The levy rates are determined after taking into account key parameters including:

- the estimated time spent on the supervision of the industry (this is used in apportioning the cost of supervision by industry sector);
- APRA's estimated supervision costs and estimated relevant costs of the ATO and ASIC;
- the current levy rates, minimum and maximum levies; and

[27] Wallis Inquiry Recommendation 104: "The regulatory agencies should collect from the financial entities which they regulate enough revenue to fund themselves, but not more. As far as practicable, the regulatory agencies should charge each financial entity for direct services provided, and levy sectors of industry to meet the general costs of their regulation." (Financial System Inquiry Final Report, 1997, pages 68, 532)

- the asset values of entities, the expected growth of assets and any changes to the industry from mergers, takeovers and deregistration.

2003 Review of the Levy

104. AIST specifically refers this Committee to the Review undertaken by Treasury in April 2003, the report of which is named, the 'Review of Financial Sector Levies - Treasury/APRA Issues and Discussion Paper'.[28]

    104.1 The contents of this recent review of the levy may obviate the need for the Committee to reconsider this issue again.

Benefits of retaining the current funding arrangements for prudential regulation

105. The current framework ensures accountability, efficiency, transparency and equity for superannuation fund Trustees. It is equitable as it is currently based on assets of the superannuation fund, thereby ensuring that the larger funds pay more and the smaller funds pay less. It is somewhat reasonable to assume that the larger the fund, the more work for the regulators to service it.

106. The levy, as it stands, arguably encourages superannuation fund Trustees to perform better, as they know that any increases in regulator activity will need to be funded, and as the levy is paid directly by Trustees, there is some incentive to perform in accordance with the Regulators' expectations, to avoid unnecessary increases in the levy.

107. The levy is easily administered by APRA, as it is a flat fee determined on equitable grounds across the industry as whole.

    107.1 As an alternative to the current system, if APRA were to set the levy in accordance with the amount of time spent regulating a particular superannuation fund, the administrative difficulties in keeping track of that information would be impractical to implement. The costs involved in that kind of change would only increase the levy further.

    107.2 Also, a "user-pays fee-for-usgae" type arrangement would not take into account the fact that the levy pays for a number functions which are performed by the three regulators (APRA, ASIC & ATO) regardless of whether the Trustees are utilising those particular functions – for example, the operation of the Superannuation Complaints Tribunal ("SCT"), ASIC consumer protection work in relation to financial products and services and the ATO costs of administering the lost members function and operating the arrangements dealing with unclaimed superannuation monies. These functions still need to be performed regardless of whether the Trustees have complaints at the SCT, lost members or unclaimed money to give to the ATO.

108. Although the current system results in some levy cross-subsidisation between superannuation fund Trustees, AIST believes it is the preferred option for the reasons of uniformity, accountability, equity, transparency and ease of administration for the Regulators.

[28] http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=587

TERM OF REFERENCE 11 – WHETHER PROMOTIONAL ADVERTISING SHOULD BE A COST TO A FUND AND, THEREFORE, TO ITS MEMBERS

RECOMMENDATION 11

AIST submits that the cost of promotional advertising should be a cost to the fund, and therefore its members, consistent with any other financial institution or business. These costs are not inconsistent with the SIS "sole purpose test" or with the "run only to profit members" or "not for profit" structures, and are necessary parts of running a business, especially in a "Choice of Fund" environment. Promotional advertising also encourages a competitive superannuation industry, which benefits members and their retirement savings.

Promotion and advertising necessary for superannuation funds in a "choice" environment

109. With the introduction of Choice of Fund into the superannuation industry, it has been essential for superannuation funds to retain its current members and attract new members to continue to run a viable superannuation fund.

110. All superannuation funds, regardless of whether they are industry, corporate, public sector or retail funds, should have equal access to the market to advertise and promote their superannuation fund. It is in the best interests of members to do this. However, as AIST has previously publicly stated in relation to superannuation choice changes, choice of fund created a potential for marketing costs to escalate. Whilst reasonable advertising costs are necessary, AIST believes there is a need for Trustees to be vigilant in keeping those costs low for members.

    110.1 Competition for choice of superannuation funds is fierce. Superannuation funds must be able to compete openly and transparently with other funds on a level playing field and in the same manner, within reasonable limits. Well-targeted, judicious communication campaigns to members is appropriate.

Equity between superannuation funds – creates healthy competition and better retirement benefits for members

111. Superannuation funds, in building members' retirement benefits, have an obligation to grow their fund. The bigger the fund becomes, the more bargaining power it has, the more economies of scale it can produce and ultimately, the more members' retirement benefits are maximised.

112. Promotion and advertising is a normal cost to any business and a superannuation fund is no different. It is a normal business expense in a competitive market. Competition is a necessary part of any healthy market sector and the lack of competition can affect the quality, price and services offered to consumers. Competition in the superannuation

industry will only benefit members as superannuation funds will have to improve their products to retain current members and build their funds.

113. It appears that in some sections of the industry, there is a view that members of "for profit" superannuation funds do not pay for the promotional or advertising costs of those superannuation funds, as compared with "not for profit" or "run only to profit members" funds. In AIST's view, this is incorrect. Costs of advertising and promotion are passed onto members either directly or indirectly, depending upon the accounting practices or corporate structures of the particular superannuation fund.

    113.1 AC Nielsen recently released its research results relating to the cost of advertising for banking, superannuation and insurance products of the top five banks in Australia. In total, the top five banks spent $45.5 million dollars on their advertising costs during the June 2006 quarter. This was reported to be more than double the amount spent by industry funds over the whole year.[29] AIST believes that those costs would have naturally been passed onto the banks' clients and members, at least in part, if not in full.

114. If "not for profit" or "run only to profit members" superannuation funds are prevented from competing in the superannuation market through promotional advertising, it would be to the detriment of the millions of Australians who are members of these types of funds.

Promotion and advertising not inconsistent with SIS "sole purpose test"

115. The "sole purpose test" is a fundamental requirement that must be observed by every Trustee of a superannuation fund – it is the guiding principle of superannuation trust law in Australia.[30]

116. it provides that the superannuation fund must be maintained solely for one or more of a number of prescribed "core" purposes (such as providing superannuation benefits on retirement, reaching age 65 or death) or for one or more of the "core" purposes **and** for one or more of a number of "ancillary" purposes (such as providing benefits due cessation of work due to ill-health). [31]

117. APRA released its Sole Purpose Circular in February 2001. On 14 March 2005, in light of the media attention regarding Choice of Superannuation Funds, APRA wrote an open letter to all Trustees of Regulated Superannuation Funds to advise them of its position in relation to advertising. This letter and the Circular provides the following guidance to Trustees in relation to the sole purpose test:

    - Advertising and promotion is not necessarily in contravention of the sole purpose test (except where the purpose of the advertising is such that it has not been primarily to inform and educate existing members or where it imposes the cost of the advertising on current members primarily to attract new members);

[29] Reported in the Financial Standard Email Newsletter, 1 September 2006, item 5, by Alex Dunnin.

[30] Section 62 of SIS and Regulations 1.03 and 13.18 of the SIS Regulations.

[31] APRA Superannuation Circular No. III.A.4 – *The Sole Purpose Test,* February 2001, Paragraph 6.

- The sole purpose test must be broad enough to encompass the **normal activities** of a superannuation fund Trustee, which must include enabling Trustees to provide retirement benefits to Fund members;
- a guiding principle to follow is that *"there should always a be a **reasonable, direct and transparent connection** between a particular scheme feature or **Trustee action**, and the **core or ancillary purposes.** The more tenuous the linkage between a service or activity and the retirement savings objective, the greater will be the difficulty in the fund meeting the sole purpose test."* [32]
- *"Trustees are entitled to levy reasonable charges against contributions, accruals or fund assets to **reimburse expenses** incurred for making services available to members, provided those services are **reasonably incidental to running of the fund**."* [33] (Our emphasis.)

118. AIST submits that the sole purpose test is not breached through advertising and promotion given that:
    - on the whole, due to the trust structure, Trustee companies and superannuation funds do not have assets of their own from which the cost of advertising could be deducted;
    - the fact that advertising is conducted to retain current members and as a by product can assist in attracting new members, to help the Trustee continue to provide retirement benefits for its members;
    - the Trustee itself does not derive a financial benefit from growing the fund and retaining members; and
    - that due to the improved economies of scale that can be generated by Trustees to then ultimately improve members' retirement, death, ill-heath and other benefits under the fund (and not increase fees or other costs of running the fund), it has a direct impact on the improvement of members' benefits for the core and ancillary purposes under SIS.
119. In summary, advertising and promotion is a normal activity of a super fund Trustee – just like printing costs, professional fees and insurance costs. When advertising is used with the ultimate goal of improving members' retirement and other benefits under the Fund, it is not in conflict with the sole purpose test.
120. Further, in using the example of the recent Industry Funds advertising Campaign entitled, a "Lifetime of Difference" and "Compare the Pair", there was a "***reasonable, direct and transparent connection*"** between that advertising, and the core or ancillary purposes of the superannuation funds involved.
    120.1 The economies of scale that would be improved as result of that advertising for both current members and prospective members, would have a direct impact on the current and prospective members' retirement benefits of the Fund.

[32] Ibid, Paragraph 42.
[33] Ibid, Paragraph 38.

120.2 Economies of scale also enables superannuation funds to offer better and more enhanced services to its members. This is because the fund will be more competitive and have greater bargaining power in relation to investment managers, insurance arrangements, costs in relation to member communication material and other services.

TERM OF REFERENCE 12 – THE MEANING OF THE CONCEPTS "NOT FOR PROFIT" AND "ALL PROFITS GO TO MEMBERS"

RECOMMENDATION 12

i. "Not for profit" is a widely understood and commonly used term within the community. In the superannuation industry, it is used to differentiate superannuation funds which are established solely to benefit members from those established to also profit shareholders or other individuals.

ii. Many of AIST's members identify as "run only to profit members" style superannuation funds (also known as "all profits go to members" and as "not for profit"). AIST submits that these terms are essentially marketing terms used to distinguish those funds from other funds who pay dividends to shareholders as well as returns to members' accounts.

iii. "Run only to profit members" or "not for profit" style funds return all earnings to members (as distinct from shareholders or other parties), less taxes, fees and costs. Members receive a declared net crediting or earning rate on their superannuation accounts. There are no shareholders who compete with members for returns or profits.

Meaning of the concepts "all profit to members", "not for profit" and "run only to profit members"

121. The terms, "all profit to members", "not for profit" and "run only to profit members" are essentially marketing terms to distinguish those style of funds with funds which return profits to shareholders as well as to members.

122. Funds which are run only to profit members return all earnings to members (as distinct from shareholders or other related parties), less taxes, fees and costs. Members of these types of funds receive a declared net crediting or earning rate on their superannuation accounts. In these types of Funds, there are no shareholders or a parent company which also financially benefits from holding that superannuation on trust for members.

123. "For profit superannuation funds", which are often owned by or on behalf of shareholders, are required to return profits to shareholders, as well as a share of earnings to members. AIST believes that these two competing priorities results in a fundamental conflict of interest. SIS requires superannuation fund Trustees to act in the best interests of members, not shareholders.

TERM OF REFERENCE 13 – BENCHMARKING AUSTRALIA AGAINST INTERNATIONAL PRACTICE AND EXPERIENCE

RECOMMENDATION 13

AIST submits that benchmarking Australian superannuation system against international practice and experience will result in Australia's system being found to be one of the best retirement systems in the world and a leader amongst OECD nations.

Australia's Retirement Income Policy – "Three Pillars"

124. AIST believes that Australia's retirement system is one of the best in the world. It is based on the "Three Pillars" Retirement Income Policies. This is made up of:

- **social security benefits and the age pension**, providing a safety net for low-income earners;
- **compulsory superannuation**, which will provide a minimum level of superannuation; and
- **voluntary savings**, encouraged by tax concessions and rebates which provide incentives for additional savings.

125. This framework is egalitarian, fair and comprises a number of different mechanisms by which Australians are encouraged to save for retirement.

Benchmarking Australia against international practice experience

126. AIST supports the benchmarking of the Australian superannuation system against international experience. Research conducted by the World Bank and the OECD (amongst many others) confirms Australia's position as a leader in this field.

126.1 Whilst AIST supports this benchmarking in principle, for the research to be useful, the comparisons or benchmarking will need to be conducted against comparable superannuation systems.

127. The current "three pillars" framework results in a fully-funded retirement system. Retirees are not reliant on unfunded liabilities to pay for their retirement.

[34] Refer to http://www.industrysuper.com.au/ for more information about relevant assumptions, fees, earnings and other important information.

128. Further, the social security system, based on both income and asset tests is reasonable enough to balance both an adequate standard of living for the recipient, but not too costly for tax payers to fund.

129. AIST believes that the mix of compulsory superannuation (forced retirement savings), along with appropriate incentives to encourage voluntary savings, as well as the age pension for those persons who have not had the opportunity to participate in either compulsory or voluntary retirement savings is an adequate framework to continue into the future.

    129.1 Whilst it supports the current retirement framework in Australia, AIST has concerns for those Australians whose salaries are below the $450 SG threshold per month, which excludes them from receiving SG employer contributions, and the Australians who are on Centrelink benefits or receive "cash in hand" pay, where they are not eligible to receive SG contributions. The Australians who fall into this category will have a much lower standard of living in retirement than those who received the SG contributions.

130. AIST supports the "run only to profit members"/no dividends payable to shareholders and no payments of commissions to advisers framework as the preferable choice for superannuation savings. The current representative Trustee system (where employee and employer representatives are elected to the Board of Trustee companies – known as "equal representation") is an equitable, fair and reasonable approach to superannuation management.

TERM OF REFERENCE 14 – LEVEL OF COMPENSATION IN THE EVENT OF THEFT, FRAUD AND EMPLOYER INSOLVENCY

RECOMMENDATION 14

AIST submits that the current framework for compensation for theft and fraud in a superannuation context are adequate. In relation to employer insolvency, AIST submits that the Superannuation Guarantee legislation should require that employer contributions are received monthly and not quarterly, to guard against employer insolvency and loss of members' retirement benefits.

Current compensation framework

131. Under the *Superannuation (Financial Assistance Funding) Levy Act* 1993, levies are imposed on superannuation funds and approved deposit funds for the purpose of funding financial assistance to any such funds that have suffered loss as a result of fraudulent conduct or theft. This scheme does not extend to employer insolvency.

132. Under Part 23 of SIS, there is provision for the grant of financial assistance for certain superannuation entities that have suffered loss as a result of fraudulent conduct or theft, determined by the relevant Minister.

133. There is a maximum amount that can be paid under the scheme, which is limited to the amount of the loss suffered.

134. Under section 223 of SIS, the financial assistance is subject to the following conditions:

(a) a condition that the amount of financial assistance granted will be deposited in the corpus of the fund;

(b) a condition that the amount will be applied, within a period determined by the Minister:

(i) in making payments to beneficiaries in the fund; or

(ii) for the benefit of the beneficiaries in such other manner as the Minister approves in writing;

(c) a condition that a trustee of the fund will prepare and give to the Minister such reports on the application of the amount as are required by the Minister;

(d) such other conditions (if any) as the Minister determines and notifies in writing to a trustee of the fund.

Trustee liability insurance

135. It is also important to note that there is a general requirement for a Trustee to hold a Professional Indemnity or Trustee Liability Insurance Policy as part of APRA RSE Licensing. Generally these insurance policies provide for a claim to be made on the basis of director and officer fraud or theft.

136. This provides another alternative for the Trustee to pursue in the event of fraud and theft, apart from the compensation scheme.

APRA RSE Licensing & theft and fraud

137. Under the RSE Licensing regime, there were significant risk mitigation strategies, especially involving strategies for the minimisation of fraud and theft, which were required to be implemented by superannuation Trustees in order to obtain their Licence. For example:

137.1 Trustee directors, and staff who occupy management roles in the Trustee office, were required to submit to an Australian Federal Police Check to determine if they had any dishonesty offences recorded against them;

137.2 The issue of fraud and theft had to be specifically dealt with in the Trustees' Risk Management Strategy and Plan; and

137.3 Trustees were required to obtain and maintain an insurance policy specifically to cover director and employee theft and fraud.

138. These RSE Licence initiatives has significantly lessened the likelihood of a wide-spread or massive fraud.

Employer insolvency

139. Under the current system, employers are required to pay their Superannuation Guarantee ("SG") contributions on behalf of employees

within 28 days of the end of the quarter in which the SG contributions fall due.[35]

140. Three months is a short time for problems to occur in business. It is quite conceivable that an employer could suffer financial difficulties and not be able to pay three months' worth of contributions on behalf of tens or hundreds of employees. The collapse of Ansett is a recent example of such an event occurring.

    140.1 Implementing a legislative provision to require employers to pay their SG contributions monthly will help prevent the loss of members' retirement benefits and guard against the risk of employees losing their superannuation entitlements due to employer insolvency.

TERM OF REFERENCE 15 – ANY OTHER RELEVANT MATTERS

RECOMMENDATION 15

AIST submits that the $450 threshold for eligibility for Superannuation Guarantee contributions be removed as it is inequitable. Its removal would also ease some of the regulatory complexity on employers in relation to superannuation.

Removal of the $450 threshold for eligibly for SG contributions for employees

141. The current SG legislation states that to be eligible to receive SG contributions of 9%, the worker must be earning at least $450 per month. Whilst all low income earners are affected by this threshold, it affects women in particular. Many women who have left the workforce to have children return to work in a part time or casual capacity. Often women are undertaking two or more part time jobs and with two different employers, and may not reach the $450 threshold in either job, which disentitles them to the SG contribution. Even though the worker may be earning a combined income of over $450 per month, the worker will not be entitled to any SG contribution from either employer.

142. Statistics provide that women live longer, but due to income disparities and breaks in employment for child rearing, women have less superannuation savings than men. The increased casualisation of the workforce contributes to this, and can result in some women missing out on SG coverage entirely and over many years. This will have an extreme impact on their retirement savings and on their reliance on the public purse for their retirement funding.

143. AIST supports the removal of the $450 threshold for entitlement to SG contributions, as it would be a productivity saving for employers, as they would not have to calculate each employee's entitlement to SG each month. This would ease the regulatory complexity on employers and

[35] For example, for the first quarter of the year (1 July to 30 September), the SG contributions must be received by the ATO by the 28th of October.

create equity for all employees, especially women, who would then all be entitled to receive 9% SG on their ordinary time earnings.

E. AIST Contact Information

Should the Committee require further information, AIST would be happy to assist the Committee. The Committee can contact the following persons from AIST:

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