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

Dear Mr Sullivan

Inquiry into the structure and operation of the superannuation industry

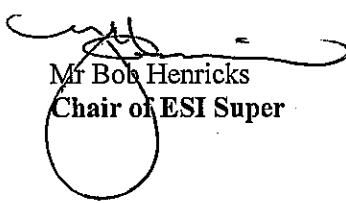
ESI Super is a Queensland based Industry Superannuation Fund, specializing in providing superannuation products and services to over 18000 members, mostly in the electricity supply industry in Queensland. We have approximately \$2.4 billion in funds under management, spread across both defined benefit and accumulation accounts.

Our membership has active (employed members) and over 5000 retained members (members no longer employed with a participating employer of the fund) for whom we provide allocated pensions, market-linked pensions, various member investment choice options, financial planning services and member education services.

We also take this opportunity to thank the Committee Secretary for an extension of time to prepare our attached submission. We look forward to cooperating with the Committee with a view of obtaining mutually acceptable outcomes.

If you have any queries in relation the attached submission or would like to discuss any part of the submission in more detail, please contact Mr Matthew Griffith (Financial Planning Manager and Assistant Fund Secretary) on (07) 3231 6253 or Karen Gibson (CEO) on (07) 3231 6244.

Kind Regards


Mr Bob Henricks
Chair of ESI Super

Executive Summary

The Trust Structure

Superannuation funds operate as a special type of express trust. Implicit in a trust structure, is the special relationship that exists between a trustee and the beneficiaries. This relationship is known as a fiduciary relationship, and is a common law obligation. The key elements of a fiduciary relationship can be described as follows:

"where one person is obliged, or has undertaken, to act in relation to a particular matter, in the interests of another and is entrusted with a power to affect those interests in a legal and practical sense, and where there is a special vulnerability of those whose interests are entrusted to the power of another".¹

A key advantage of a trust structure is that fiduciary duty requires a trustee to act in the best interest of beneficiaries. *This structure has served the industry well over a very long period of time, helping to ensure that the interest of the trustee is directly aligned with the beneficiaries.*

In contrast, in the case of a company structure, directors are required to act in the best interest of shareholders. Implicit in this structure is the shareholders expectation that directors will act in the interest of shareholders by generating a return on the shareholders capital.

The difference between the two structures is subtle, but becomes apparent when you consider the operation of a corporate entity as a trustee, where the corporate entity has shareholders with an expectation that the company will generate and distribute profits. In this case, a tension exists, whereby the directors are operating concurrently in two separate and distinct roles. The role of a corporate trustee requires the company to act in the best interest of beneficiaries, while the role of director requires the director to act in the best interest of shareholders. There is a potential conflict of interest, particularly where the trustee is capable of charging the trust for services rendered by the company.

In terms of the operation and structure of superannuation, and the industry's ability to provide an efficient, effective, and safe regulatory structure for the management of superannuation funds, we are of the view that the fiduciary relationship between trustees and beneficiaries is sacrosanct. Nothing is more important to the members, who are relying on trustees, than preserving this fiduciary relationship between trustee and beneficiary.

¹ *Hospital Products Ltd v United States Surgical Corporation (1984) 156 CLR 41, cited in Bartlett, R, "A Fiduciary obligation respecting the delivery of services to the Aboriginal communities", Australasian Law Teacher's Association, Cross Currents: Internationalism, National Identity And The Law, 1995 (footnote 1.*

Adequacy of Retirement Savings

Whilst we acknowledge the Federal Government's recent initiatives in terms of simplifying the superannuation system, we are of the view that the real issue is adequacy, not simplicity.

Quite simply, 9% of salary over a 30 year period is not enough. Making matters worse, approximately 50% of the workforce has only had the benefit of compulsory superannuation since the advent of the superannuation guarantee in 1992, with the 9% levy only coming into effect from 1999. This was not soon enough, but will still leave most people short of the mark.

Instead of easing contribution restrictions and facilitating the increase of contributions, the Government has tightened contribution rules under the budget proposals, capping the maximum deductible limit to \$50,000 per annum, and limiting after tax contributions to \$150,000 per annum.

In terms of the ability of the superannuation system to provide an efficient and effective regulatory structure for the management of superannuation funds, surely the objective should be to increase retirement savings. *In this regard, we urge the Senate Committee to focus some attention to whether 9% of salary is enough, and if not, what can be done to help promote higher levels of compulsory superannuation.* In this regard, we believe that a compulsory employee contribution linked with a government co-contribution could be added to the existing compulsory contribution regime. We would be very interested in any modelling from Treasury in relation to this proposal in terms of the cost, relative to the long-run benefits of higher retirement savings and a reduced reliance on government supported age pensions.

Managing longevity risk

Over the last 50 years, life expectancy has increased by 10 years. Given the advancements in medical technology, it is likely that life expectation could increase by a greater margin in the next 50 years. This presents a significant challenge for retirees, who will be required to manage their retirement capital over longer periods of time.

In this regard, we are cautious about the new pension rules, which provide no mechanism to manage retirement savings over a period of average life expectancy and beyond. Under the new rules from 1 July 2007, there is no legislative restraint to prevent an individual over the age of 60 of making significant tax-free benefit withdrawals in a short duration for house upgrade/renovations, and, provided their assessable assets are low enough, gain access to the age pension.

The role of advice

Given the complexity of superannuation and financial products, Financial Planning has a critical role to play in helping individuals attain their lifetime financial goals, across a broad spectrum of investments, insurance, superannuation, tax, asset protection, and estate planning.

Whilst some criticism has been aimed at commissions and trails in general, we are of the view that individuals should be able to make an informed decision about what services they require, and how they pay for such services.

However, there is a structural issue in the financial services industry in that some financial planning business models are more akin to a product distribution model than a genuine advice distribution model. Retail financial services businesses actively encourage the promotion and distribution of their financial products through networks of advisers, restricting the list of financial products that their advisers can recommend, and the payment of incentives to advisers and platforms for the preferential distribution of products. This is simply a product of the commercially competitive environment of financial services, which has only been heightened under the choice of fund environment.

It is generally accepted that competition should be good for consumers. However, it is arguable whether the role of advice under the choice of fund regime is benefiting the consumer. This was confirmed by the recent ASIC Shadow Shopper Survey in April 2006 which confirmed that some advisers are recommending clients switch between superannuation providers for no credible reason, potentially leaving the consumer worse off. ASIC found that inappropriate advice was three to six times more likely where the adviser had a conflict of interest.

In relation to the role of advice in superannuation, we would be more than happy to provide the Senate Committee with further information.

Responses to the Terms of Reference

1. Whether uniform capital requirements should apply to trustees.
 - a. What would be the purpose of mandatory capital requirement?
 - i. Action by members against a Trustee? Trustees are required to hold insurance to protect the members against the inappropriate action of trustees. It is arguable whether a mandatory requirement to hold reserves in addition to insurance will provide substantial benefits to members.
 - ii. Operational risk? The RSE licensing regime requires Trustees to implement sufficient controls in relation to operations and risk management. It is also becoming increasingly common for large funds to outsource the custodian function. Custodians are required to hold \$5 million in net tangible assets and by requiring super funds to also meet uniform capital requirements arguably represents overkill in risk reserving.
 - iii. Un-insurable risk? How would capital adequacy be calculated and under what condition would a capital adequacy reserve be applied to meet a claim that would not be covered by insurance or from the fund itself?
 - b. Ensuring that there are strong internal controls is a more proactive approach to managing risk and protecting the fund. The current regulatory authorities and systems, in addition to superannuation fund auditors being required to report to APRA, seems an appropriate and more positive approach to risk management.
 - c. If the Senate Committee consider that uniform capital adequacy should be mandatory, how do they propose that such reserves be funded for non-public offer and self-managed funds? In such cases, the Senate Committee should consider whether Trustees can fund a capital reserve by diverting investment returns into a reserve held within the fund.
 - d. What is the evidence to suggest that current regulations, supervision and Trustees risk management systems are ineffective or inappropriate to warrant uniform capital requirements? Whilst there have been some failings by trustees, such failings appear to be a very small proportion of the total market. We are of the view that the current prudential mechanism has not proven to be inadequate.
 - e. A large part of the industry has been operating without mandated capital adequacy requirements and we question the validity of making capital adequacy a mandatory requirement. Each Trustee in conjunction with APRA should be able to make a determination in relation to their capital adequacy to cover operational risk, suited to the risk profile of their fund.

We question the value of making capital requirements a mandatory requirement. Any mandatory capital adequacy requirements would need to be considered against a cost/benefit analysis, and against the inherent risk factors of superannuation funds, which varies from fund to fund.

2. Whether all trustees should be required to be public companies.
 - a. There is no inherent advantage in requiring a public company to be a trustee. The appointment of a public company as a Trustee will not guarantee ethical and rigorous behaviour of directors as evidenced by many of the corporate failures (e.g. HIH, Enron). What evidence is there to suggest that a public company will do a better job than the current trustee structure?
 - b. In any case, a company acting as a trustee will be bound by trustee responsibilities in addition to the statutory and common law obligations required by directors. Apart from additional disclosures required by public companies, it is hard to fathom what material benefits would be gained by requiring trustees to be public companies.
 - c. If all trustees are required to be public companies, does this mean that such trustees will be required to conform to requirements usually associated with a public company? If so, who wears the extra compliance costs associated with operating a public company as trustee?

We are of the view that a public company does not provide any additional assurances of director/trustee behaviour nor does it provide additional security to the funds invested. Trustee common law responsibilities prevail regardless of the entity charged with Trustees' responsibilities. This proposal would need to be considered against a cost/benefit analysis which we doubt would be able to provide a conclusive case in favour of requiring trustees to be public companies.

3. The relevance of APRA standards.
 - a. APRA's role is to supervise trustees in the context of the Superannuation Industry (Supervision) Act 1993 and associated Circulars. One of APRA's key roles is to ensure that superannuation trustees have adequately assessed and implemented risk management controls in accordance with relevant legislation. Trustees are required to provide evidence to APRA that ongoing controls are in place to ensure that good risk management practice is being maintained. The SIS Act and associated Circulars, under the supervision of APRA, have a vital role to play in ensuring that the operations of superannuation funds provide members with a safe, efficient, and effective vehicle for their retirement savings.
 - b. Superannuation Trustees are also required to comply with the Corporations Act (monitored by ASIC), and the Tax Acts (administered by the ATO). Other legislation and common law duties also impact on Superannuation Trustees (eg. Family Law, etc). The interaction between

the various facets of statute and common law make superannuation a highly complex and regulated industry.

- c. We believe that the Government should investigate the feasibility of consolidating the superannuation supervisory functions performed by APRA and ASIC under the umbrella of a single regulator.

There is no reason to suggest that the Superannuation Industry (Supervision) Act, and the associated Circulars, under the supervision of APRA are irrelevant or ineffective. However, we believe that the Government should investigate the feasibility of consolidating the supervision of APRA funds (in terms of the Corporations Act and SIS Act) under a single regulator to minimise overlap and enhance the efficiency of the regulatory supervision process.

4. The role of advice in Superannuation.

- a. The environment of superannuation choice has had a two fold effect:
 - i. The unlocking of members from employer designated superannuation funds has provided additional opportunities for members and financial advisers.
 - ii. Members are required to make a conscious decision in relation to their superannuation. Some members are capable of making a well informed decision in relation to their preferred superannuation provider. Other members are not, and in this regard, lack of financial literacy appears to be the key issue.
- b. The choice environment combined with the complexity of the range of financial products (including superannuation and member investment choice) means that members need quality and ethical advice to help guide them in attaining their long-term financial retirement goals.
- c. Without a doubt, one of the most important financial decisions an individual will make is in relation to how to fund their long-term retirement goals. We are of the view that quality advice in relation to superannuation is only one side of the story. Almost all matters relating to members' affairs, which are focused on the provision of retirement income, need to be considered. For example:
 - i. Exploring the capacity for a person to take advantage of superannuation tax concessions by winding up or transferring non-superannuation investments to superannuation to provide superannuation income streams.
 - ii. Exploring the capacity for a person to maximise their superannuation contributions through their employment and, where relevant, using the individual's investment entities (family trusts, partnerships, private companies, etc) to aid in the funding of superannuation contributions and retirement benefits.
 - iii. Exploring the capacity for a person to downsize the family home to fund a shortfall in total retirement benefits.

- iv. Exploring the capacity for a person to access the small business capital gains tax concessions to allow the member and his/her dependents to apply the sale proceeds of a small business towards superannuation in a tax effective manner.
 - v. Assisting a person to attain centrelink and/or DVA concessions where there is a shortfall between their actual and required retirement income.
- d. The impact of the Financial Services Reform, whilst arguably enhancing the quality of advice, has undoubtedly increased the cost of providing compliant and quality advice.
- e. Whilst we acknowledge the value of advice in relation to superannuation, we recognise that some financial planners and organisations have inappropriately taken advantage of the superannuation fund choice environment to advise members to switch between superannuation providers where there is no material advantage accruing to the member/client. This issue was highlighted in the ASIC Shadow Shopper Survey in April 2006 where ASIC concluded that:
- i. Where consumers were advised to switch funds, a third of the advice lacked credible reasons and risked leaving the consumer worse off.
 - ii. Unreasonable advice was three to six times more common if the adviser had an actual conflict of interest over the advice given to the client. These conflicts were commonly created where either the adviser stood to get higher remuneration if the recommendation was followed, or the recommended product was associated with the adviser's licensee.

Advice has a crucial role to play in relation to superannuation and indeed, to the Australian community for all aspects of an individual's financial circumstances. However, there appears to be an element of the financial planning industry who, to the detriment of their financial planning profession, are making inappropriate recommendations for members to switch between superannuation providers for no apparent advantage to the member.

We encourage the Government to continue to reform the Financial Services legislation for the benefit of members, and the financial planning community, with an emphasis on enhancing legislation to facilitate unbiased, quality and affordable advice for members.

5. The meaning of member investment choice.

- a. The purpose of member investment choice is to provide members with a range of investment options to reflect the members' investment return objectives at an acceptable level of risk (ie. the members risk "appetite").
- b. The importance of member investment choice is highlighted by the fact that for some members, their contribution rates will not be sufficient to meet their retirement objectives. Thus, for some members, they will need to make some decisions:
 - i. To increase contributions (without detriment to their required cash flow)?
 - ii. To increase the potential for higher returns by choosing investment options with a higher weighting to growth style assets?
 - iii. Varying combinations of the above.

The reality is that some members will not be able to afford to increase their contribution rate, and so will rely on investment returns to help fund their retirement income. Accordingly, some members will not like a "one size fits all" approach to investments, and will prefer to have the option to alter their member investment choice to suit their individual circumstances.

Member investment choice is crucial to providing members with the flexibility to manage their overall financial circumstances.

- c. Providing members with member investment choice is, in itself, not sufficient. Investment education and quality advice is also necessary to help members to select investment choices which are consistent with their risk/return appetite and required investment duration. For example, the member investment choice should take into account when and how superannuation will be accessed to pay a pension, to repay home loans, buy a caravan, etc.

Member investment choice is where Trustees provide members with the ability to choose between different mixes of asset classes. This provides the opportunity for members to meet their individual circumstances taking into account their risk/return tolerance, duration of their superannuation investment, other personal assets etc. Quality advice and education also has a major role to play in assisting members in exercising member investment choice to maximise its effectiveness.

6. The responsibility of the Trustee in a member investment choice situation.

- a. The investment return for a typical balanced fund obtained by a Trustee, depending on a member's contribution rate, can account for 80% of a member's total account balance at age 60. Small differences in crediting

rates over long periods of time have a major impact on the total quantum of a members retirement benefit. Trustees obviously have a major responsibility on behalf of members in managing not only the derivation of member returns, but also providing members with education and advice to help members make the best possible investment choice for their individual circumstances.

- b. Trustees have discretion in relation to the nature and number of member investment choice options, taking into account, amongst other things:
 - i. The membership demographic profile;
 - ii. The benefit design of the fund;
 - iii. Economic factors such as inflation;
 - iv. Demographic trends such life expectation, mortality, etc;
 - v. Recommendations made by investment specialists;
 - vi. The Trustee investment objectives and associated investment risk management policies;
 - vii. Asset allocations for member investment choices;
 - viii. Legislative environment;
- c. We believe that trustees should be able to offer a range of member investment choices commensurate with the ability of their members to understand and utilise the range of investments offered.
- d. We contend that, in the absence of advice and education services, a small number of investment options provides members with sufficient choice, without confusing members by inundating them with options.
- e. The media, and public commentators have participated in heightening investor anxiety by focusing on short term results and volatility. Short-term results lose relevance when you consider that current life expectation is approximately 80 years of age, meaning that a member who is 30 years of age has a 50 year investment time horizon (not taking into account future improvements to life expectation). Managing members' short term return expectations is a significant challenge for Trustees. We are of the view that:
 - i. Trustees are obliged to provide the member with education and advisory services where Trustees provide members with greater than one investment choice.
 - ii. Because the Government has introduced the choice environment they are also have a responsibility to provide education to members.

We are of the view that Trustees are responsible to ensure that:

- 1) The member investment choice options, and the associated default selections, developed by the fund, are adequate for the spectrum of members within the fund;*
- 2) The member investment choice options, underlying asset allocations, and defaults are monitored regularly;*
- 3) Where member investment choice is offered, they provide education and advice services.*

4) The Fund achieves after-tax returns that will maximise the retirement benefits of the members over a very long period of time (not necessarily generate the largest returns with higher volatility over shorter durations).

5) The relationship between fund costs and returns is monitored by Trustees to ensure that members obtain value for money for the products and services offered.

7. The reason for the growth in self managed superannuation funds (SMSF).

Potential reasons for growth in SMSF's include:

- a. Highly skilled and competent individuals who can self-manage their investments at a reduced cost and with greater control.
- b. Access to specific investments not available within a large fund environment (eg. real estate investment properties).
- c. The influence of accountants and financial planners who have recommended the establishment of SMSFs which they then administer, audit and sometimes invest for the member.
- d. Under the pre 12 May 2004 rules, SMSFs were able to pay defined benefit pensions, providing the member with considerable estate planning advantages, control of the actuarial reserves, and RBL compression.
- e. The ability for individuals to participate in a SMSF which owns a business property that is in turn rented back to the related business on an arms length basis.

Issues in relation to the growth of SMSFs:

- a. There is a perception that a minimum of \$200,000 is required to create economies of scale and cost efficiencies through the establishment of a SMSF. We dispute this figure. In our experience some large superannuation funds can administer a member's account and invest the member's money at a total cost which would indicate that member needs much more than \$200,000 to cost effectively transfer from a large fund to a SMSF.
- b. For example, consider a member with \$200,000 invested in a large fund with a total cost of 0.70% to the member (including investment and administration costs). For that member to attain cost efficiencies in transferring \$200,000 to a SMSF, the SMSF total costs must be below \$1,400 (SMSF costs can include administration, investment, audit, tax returns and opportunity cost of the member's time and effort).
- c. We are concerned that some individuals have been inappropriately advised to leave large, low cost and high performing super funds and rollover to a SMSF.

In the choice of fund environment, there are many alternatives available for individuals for their superannuation retirement savings. SMSF's are simply one of many options in the spectrum of superannuation alternatives. The ATO is charged with responsibility for the supervision of self-managed funds, and there are sufficient safeguards and incentives for Trustees of self-managed funds to manage their superannuation appropriately.

8. The demise of the defined benefits funds and the use of accumulation funds as the industry standard fund.
 - a. With the increase in accumulation style funds, and the demise of defined benefit funds, we have seen a transfer of the investment risk and ultimate responsibility for retirement savings from employers to their employees.
 - b. We believe that most employers are no longer willing to take or accept responsibility for defined benefit plans for the following reasons:
 - i. Any periods of market downturn have the potential to depress the market values of defined benefit investments below the required vested benefits of the defined benefit plan (ie. a defined benefit deficit). Employers, at the recommendation of an actuary, are then required to increase contribution levels in a time of market decline;
 - ii. Conversely, any periods of strong market performance have the potential to increase the market values of defined benefit investments beyond the required vested benefits of a defined benefit plan (ie. a defined benefit surplus). Whilst the employers contribution rates decrease in such a period, employers are generally unable to extract these surpluses from super for use in the company business operations;
 - iii. The impact of salary escalation rates on defined benefit liabilities and the corresponding effect on employer defined benefit contribution rates;
 - iv. The impact of factors such as increasing life expectancy, inflation, etc on defined benefit design;
 - v. The accounting standards, which require companies to obtain an actuarial valuation and disclose a defined benefit liability on the balance sheet, and the potential for this to impact on the company share price;
 - vi. Defined benefit design can be complex and difficult for members to understand;
 - vii. Complexity in implementing legislative changes to defined benefit plans, such as:
 - Surcharge;
 - Family law;
 - Transition to retirement;
 - Benefit component crystallisation under the proposed budget rules.
 - viii. Extra costs of administering defined benefit plans, including:
 - actuarial costs;

- quarantining of defined benefit investments;
- determining crediting rates and reserving strategies;
- etc

We are of the view that the demise of defined benefit structures has largely been a result of employers who are unwilling to accept the complexity and investment risk associated with operating a defined benefit structure.

9. Cost of compliance.

- a. Trustees are required to comply with Statutory Law (the Corporations Act, SIS Act, Tax Law, Trust Law, and Family Law) and Common Law. There is clearly a cost in complying with these laws.
- b. We are of the view that compliance costs are a necessary and requisite requirement of operating a modern superannuation fund. However, modification and enhancement of the regulations driving compliance costs are required to ensure that members are obtaining value for money from costs associated with compliance.
- c. Some of the requisite reporting (annual reports, member statements and product disclosure statements) are costly, complex and can be misinterpreted by the members. It is difficult to conclude whether some of the disclosure requirements provide additional safeguards, enhance member understanding of their products, or provide a meaningful base to compare products. In this regard, we believe that some elements of compliance do not provide good value for members.
- d. Members should be able to opt in or out of particular disclosure requirements (eg. annual reports).
- e. We question whether it is possible to deliver a compliance program to guarantee absolute protection for members over a long period of time. In this regard, trustees and regulators need to strike a balance between the inherent risk factors associated with fund operations, industry best practice, and the costs of implementing a compliance program to obtain sufficient level of surety for trustees and members.

We are of the view that compliance costs are a necessary and requisite requirement of operating a modern superannuation fund. However, modification and enhancement of the regulations driving compliance costs are required. For example, the Senate Committee should investigate the possibility of allowing superannuation members to opt out of receipt of Annual Reports.

10. The appropriateness of the funding arrangements for prudential regulations.

We have no comment to make in relation to this item.

11. Whether promotional advertising should be a cost to the fund, and therefore to its members.
- a. The Committee should examine this issue in the context of the broader superannuation market, and the various methods employed by superannuation funds in promoting their products and services.
 - b. For example, we note the following:
 - i. Some super funds have undertaken direct advertising through mainstream media.
 - ii. Some super funds are promoted by the employment of business development managers.
 - iii. Some super funds are promoted and distributed through a network of financial advisers who are rewarded by commissions and bonuses linked to the volume of products distributed.
 - iv. Some financial institutions promote their products by restricting the choice of financial products available to their financial advisers (referred to as a product list).
 - v. Some financial institutions pay a premium to product distributors for preferential distribution of their products.
 - vi. Some super funds (eg. Self Managed Fund Services) are promoted by way of cross selling through interrelated service providers such as advisory groups, accounting groups, and other professional networks.
 - vii. Some super funds are promoted as part of a broader marketing campaign of a financial institution, with an overhead recovery billed back to the super fund.
 - c. Superannuation funds also have an important role to play in educating members about their products, and thereby assist members in making a well informed decision in relation to their superannuation products and services (eg. member investment choice, contribution rates, consolidation of super, insurance, etc).
 - d. If the objectives for promotional advertising are to attract members, retain members and in turn provide greater size/cost/servicing efficiency then all members enjoy those efficiencies and all costs should be born by them.
 - e. The Senate Committee should include in its report a direction for industry on the methods employed by superannuation providers to promote their products and services.

As a result of fund choice, all super funds are competing in the same market. A competitive environment has the potential to benefit consumers in the form of better value for money products and services. Trustees also provide educational services to members by providing them with advice and information about their fund, its operating costs, etc, with the ultimate aim of providing for their retirement benefits. If promotional activities benefit existing members as a result of the attraction of additional members, retention of

existing members, increasing contributions, and achieving greater cost and servicing efficiencies, then such costs should be absorbed by members.

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

- a. The terms of "not for profit" or "all profits go to the members" usually refer to the following scenarios:
 - i. Where the Trustee seeks no return or profit margin in relation to the operations of the fund (e.g. administration, insurance, investment). For example, funds which conduct in-house administration and member servicing functions, where such functions are conducted on a cost recovery basis.
 - ii. Where the Trustee has established a wholly owned entity, joint venture or jointly owned entity (owned in conjunction with other superannuation funds). The entity or jointly owned entity typically provides administration, investment services, and advisory/member services back to the shareholding super fund or super funds. In such cases the profits from these activities is owned by the members of the fund and not by external shareholders (i.e. the profits are distributed back to members).
- b. Under the choice of fund environment, the use of the terms "not-for-profit" or "profit for members" are used to distinguish between trustees that are returning profits to members from other trustees that are generating a return for external shareholders.
- c. We believe that not for profit funds have a role to play in the landscape of the broader Australian superannuation environment. Diversity and competition are good for the superannuation market, forcing market participants to deliver better value for money to members. Ultimately consumers should have the freedom to choose what style of superannuation structure is suitable for their particular needs. In this context, the terms "not for profit" or "profit for members" is used to describe the operating structure of the fund.
- d. It is also worthy to note that some of Australia's largest financial institutions were birthed from a "profit for members" approach. AMP, AXA, Bank of Queensland etc would not be commercial entities today if they had not started life as Mutual funds or Building Societies working for their members.
- e. We are cautious about the inclusion of this issue as part of the terms of reference and, on behalf of our members, await the Senate Committees findings with interest.

The use of the terms "not for profit" or "profit for members" are used to distinguish between Trustees that are generating a return for external shareholders ("for profit" or "for dividend" funds), and those Trustees that are not returning profits to external shareholders ("not-for-profit" or "profit for members" funds). This terminology, provided that it is used honestly, is useful for Members in a choice of fund environment to

distinguish between the varying styles of operating structures of superannuation product providers.

13. Benchmarking Australia against International practice and experience.

- a. This exercise would be useful in facilitating knowledge share between various countries which are in different phases of tackling the same problems, such as:
 - i. adequacy of private retirement savings; and
 - ii. reducing the public's reliance on government supported retirement pensions.
- b. The objective of any such benchmarking review should be to assess the effectiveness of the retirement savings system in terms of, but not limited to:
 - i. Whether the system provides a safe environment for participants (for example, are retirement savings quarantined away from company risk or from government consolidated revenue?)
 - ii. Whether the system is successful in delivering adequate retirement savings relative to a percentage of the participant's final income.
 - iii. Whether the system is successful at mitigating reliance on government supported retirement income.
 - iv. Whether the system provides the individual with flexibility to increase contribution rates.
 - v. Whether the system provides capacity for a participant to self-direct their underlying investment choice.
 - vi. Whether the system provides the participant with portability of retirement savings between jobs, and other countries.
 - vii. Whether the system provides flexibility for participants to move between retirement income product providers.
 - viii. What taxation incentives are provided to encourage participation in the system?
 - ix. What taxation incentives, penalties or mechanisms are provided to ensure that individuals draw their retirement savings as an income stream over a longer duration as opposed to drawing lump sums over a shorter duration and thereby increasing risk of reliance on government support?
 - x. What interrelationship exists between private retirement savings and government support?

The industry should be invited to participate in setting the terms of reference for any international benchmarking exercise.

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

- a. There is no evidence to suggest that existing common law and statutory remedies are insufficient. We are of the view that existing systems provide trustees and members with sufficient protection in relation to an action by a member for a fraud.
- b. In relation to employer insolvency, one of the key purposes of requiring employers to contribute to a superannuation trust was to quarantine employee pension liabilities from the operations of the company. Thus protecting employees from losing their pension/retirement entitlements if the company became insolvent or if the company used employee pension assets to fund company operations.
- c. There are additional safeguards by virtue of the in-house asset rules, which limit a superannuation fund's ability to invest in the employer sponsor, or in assets which are leased or loaned back to the employer sponsor.
- d. There is merit in examining whether employers should have to quarantine employee entitlements to protect employees against insolvency of an employer (eg. Ansett). We note that some industries are exploring this issue in terms of redundancy trusts, and long-service leave trusts.
- e. There is merit in examining the potential to tighten contribution reporting to members and for superannuation funds to monitor contributions in arrears from employers.

We are of the view that there is already sufficient common law and statutory remedies in relation to providing a mechanism for compensation to members for fraud or other Trustee failings. The requirement for employers/employees to contribute employee pension liabilities to a separate entity (eg. a superannuation trust) has been largely effective at ensuring that employee pension entitlements are protected from employer failure. The concept of quarantining other forms of employee benefits (leave, redundancy, etc) to a separate trust is a matter for government and business. We are of the view that there is merit in examining the potential to tighten contribution reporting to members and for superannuation funds to monitor contributions in arrears from employers.

15. Any other relevant matters.

- a. Adequacy of retirement savings is still the primary issue. It is widely accepted that 9% of salary over a working life of 30-40 years will not be sufficient. We believe that the government needs to explore mechanisms to increase the contribution rate to 15% to improve the adequacy of retirement savings. This could be funded as follows:
 - i. Superannuation guarantee of 9%; plus
 - ii. An employee compulsory salary sacrifice of 3% of salary; plus
 - iii. A Government co-contribution to reward taxpayers who voluntarily contribute beyond the 3% employee compulsory (eg. 3% of Average Weekly Ordinary Times Earnings).

- b. Change in employment trends (eg. part time and casual employment) has the potential to reduce superannuation coverage. We are yet to see the long-term impact of IR legislation on changes to employment trends and superannuation coverage.
- c. Greater efforts are required to increase the coverage of the superannuation guarantee, in particular, for low income and/or casual employees.
- d. Given the choice of fund environment, the Senate Committee should examine the current requirements in relation to Public Offer status for superannuation funds and whether these rules should be relaxed.

Increasing the adequacy of retirement savings and increasing superannuation coverage for all Australians are two key issues which require further enhancement. The Committee should also examine whether the current Public Offer rules are appropriate for the choice of fund environment.