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THE SUPERANNUATION PLAN FOR ELECTRICAL CONTRACTORS
QUEENSLAND- SPEC(Q)

QUEENSLAND INDEPENDENT EDUCATION AND CARE FUND - QEIC

CLUB SUPER

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ISPF PTY LTD THE MANAGER OF INDUSTRY SUPERANNUATION
PRESERVATION FUND

MEMBERSHIP OF THE FIVE ENTITIES TOTAL 177,000 MEMBERS AND THE
ASSETS UNDER MANAGEMENT ARE IN EXCESS OF \$1.03B

The following comments are made to the Senate inquiry by the Director/Trustees of the
above funds.

Issues to be raised in the Senate Committee:

1. Whether uniform capital requirements should apply to trustees.

- a. *For what purpose is the uniform capital required? If it is to provide a financial security to support any action by members against the trustee then the capital requirement of the trustee becomes a duplication of protection, as the trustee is already required to hold PI to protect the members against the inappropriate action of trustees. That PI provides additional cover for the costs of litigation in the circumstance of action against others.*
- b. *Un-insurable risk? Under what condition would a capital adequacy reserve be applied to meet a claim that would not be made by PI or from the fund itself?*
- c. *Funds that opt to go 'public offer' have already made the decision to either employ the services of a custodian or hold \$5 million of NTA as a capital adequacy requirement. If there was a capital requirement, would there be an option to employ a custodian and would those funds already with a custodian be exempt?*
- d. *Ensuring that there are strong internal controls is a more proactive approach designed to protect the fund. Both APRA and ASIC reporting and audits on the risk management controls seems a more positive approach to confirm the behaviour of trustees within accepted ranges.*
- e. *We are doubtful that capital requirements are required as PI cover meets this potential contingency.*

- f. *Auditors also have responsibility to report an opinion on the management on the adequacy of and compliant to these risk management controls and legal action can be taken against them for any breach of their responsibilities which resulted in damage to the members.*
- g. *If the Senate considers capital requirements be set aside, do they propose that the requirements be sourced from the fund? If so there is a mismatch of investment strategies to meet the capital requirements of trustees and members (for whom they are acting) whereby a capital adequacy reserve is invested in a non-performing asset unable to even meet the cash-flow requirements of the fund.*
- h. *If it's sourced by the sponsors of the fund then, to maintain the cost efficiency of the structure, the sponsors can receive no more than the bank interest reimbursements; otherwise there is a cost equivalent to the margins between the opportunity cost of the funds to the sponsor and the current investment. Potentially this could be a detriment to the sponsor and a need to be compensated. Such a need confounds the focus of the fund to achieve optimal benefits for members .*
- i. *Why is this capital requirement necessary when there is already a protection fund in the form of prudential regulation, provided by APRA, funded via the APRA Levy? This prudential mechanism has not proven to be inadequate. Indeed larger funds are supporting the smaller APRA funds with problems.*

2. Whether all trustees should be required to be public companies.

- a. *What inherent advantage is there in a Public company being the trustee? Some Funds already have public companies as the Trustee. Will a public company do the job more diligently and with greater care than a Trustee under the current structure? The appointment of a Public company and the Directors of a Public Company do not perse guarantee the ethical rigorous behaviour of directors..... OneTel, HIH, WestPoint, Ansett, WorldCom, Enron to name a few public companies, clearly evidence that a public company, in itself, does not provide any assurance of director behaviour and the security of the funds invested.*
- b. *What evidence is that there that a Public company will do a better job than the current trustee-fiduciary structure? In fact a public company, acting as a trustee, will be bound by the same trustee responsibilities under trust law and the APRA regs.*
- c. *Potential areas of conflict arise with the appointment of the Directors of a Public Company as the trustee as they are also responsible to the Shareholders of the company to meet their profit and funding obligations to ensure the solvency of that company in, perhaps, contradiction to their fiduciary responsibility to the members of the funds under trust law.*
- d. *The requirement to control trustees was a result of splitting responsibility between the ATO (individuals trustees with funds paying pensions) and ASIC (for funds providing lumps sum) requiring a corporate trustee. The*

entity itself provides no ancillary advantage in this circumstance of PI and controls and fiduciary responsibility.

- e. The APRA Standards and the ASIC Rules and an external Auditor do provide the control framework to measure and assess trustee behaviour, which the formation of a public company does not by its structure provide.*

3. The relevance of APRA standards

- a. The APRA standards require trustees to demonstrate that they have clinically assessed and implemented the risk management controls of their entire operations of managing the fund and they have to evidence that there is ongoing controls that ensure that good risk and management practice is being maintained.*
- b. ASIC, in controlling the reporting standards ensures that members are provided information that is intelligible (to a large extent, but we believe that could be further improvement into simple English). And these standards provides members with a consistency of reporting so that those members can make informed decisions about their fund and compare them to any alternatives they wish.*
- c. We believe there should be one body that administers these functions*
- d. The APRA standards set the basis for compliance and allow the regulator to assess the respective adequacy of the trustees, which together with independent external auditors report, provides an insight into the security of funds and the trustees action to mitigate unwarranted and controllable risks in the fund.*

4. The role of advice in Superannuation

- a. There is a conflict in the requirements to provide advice to a member of a Superannuation fund on superannuation issues.*
- b. APRA require that only matter pertaining to the superannuation fund benefit be considered in that advice when that advice is provided by the fund.*
- c. ASIC, on the other hand, requires that the adviser consider all factors in providing financial advice to the member.*
- d. Almost all matters relating to members' affairs, which are focused to the provision of retirement income, need to be considered and therefore the recognition, for example, that a person, just prior to retirement, could downsize the family home to fund a shortfall in his/her retirement benefit or to recognise the spouses' financial position in being able to support the retirement income streams, or to investigate the capacity of a member to access a small business rollover needs to be incorporated into the planning programme to allow the member and his dependents to retire under the superannuation umbrella.*
- e. We believe that the ASIC reporting responsibility needs to be expanded into APRA to reflect the real consulting and advice that members need to receive to manage better their retirement saving.*

5. The meaning of member investment choice.

- a. *A member investment choice is limited to the placement of the member's existing opening balance to an investment strategy and the placement of new contributions to the same or an alternate investment strategy, which, the member hopes, will provides him with the best possible retirement benefit.*
- b. *The investment time horizon for each annual contribution for a 30-year-old member is some 30 years if the intention is to pay pensions from the benefit at retirement. Essentially the contributions made this year are invested for a 30-year period to provide the pension payment when the member is aged 60 and retired or capable of commencing a pre-retirement pension. And likewise, the annual contribution paid when the member is age 59 or 60 will be invested to meet the pension payment due at age 90.*
- c. *Thus each contiguous discrete contribution made for the member over the thirty year period to retirement has a 30 years time horizon yet the marketplace continually focus on short term results and public commentators heighten anxiety by emphasising the short terms results as though the momentum of the short term can be extrapolated over the life of the fund.*
- d. *Members need to be given intense investment education and advice, which allows them to understand better the relationship of real rates of return and volatility and the range of expected returns over long periods of time. This is because their investment horizons extend from now to their death in maybe 60 years time. Included in that education, illustrations need to be given of negative returns and their impact both on the retirement benefits and the pensions to be paid. But it should also illustrate that prevailing average returns over the longer term correct the negative outcomes.*
- e. *In making investment choice, members need to also understand and analyse the duration of their investment – to assess, for example, when these contributions will be accessed to pay a pension, to repay home loans, buy a caravan, etc and so place their investments to match the period of their proposed expenditure so as to access the greatest returns from the marketplace itself. Members need to also fully understand the characteristics of the investments necessary to fund their pensions in retirement and the “impacts” of losses both on the retirement benefits and the value of the pensions to be paid over their life.*
- f. *The member needs to have the knowledge and understanding to be able to choose between the range of MICs and select those which best provides the opportunity to meet their individual benefit objectives. Such knowledge and understanding is with respect to their understanding of their risk tolerance, the duration of investment, the ability of other personal assets being applied to fund shortfalls, the timing of personal strategies to reinstate super at a later date, etc.*

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

- a. *Trustees also need to be aware of the generic investment time horizons of their members and scope the construction of their portfolios accordingly.*
- b. *We believe that trustees need to recognise that they need to offer members a limited choice of 3 to 6 well structured portfolios, (a number not too great to daunt the member and confuse him or her but with sufficient structural diversity which captures appropriate duration and risk) so members can choose an optimal mix, to meets the time horizons of their investments.*
- c. *We believe it requires education and advice, to give members the knowledge to allow them to meet their long-term retirement objectives.*
- d. *It was a Government initiative to introduce Choice of Funds and therefore the Government has essentially created the environment that has given the consumer that choice of where to invest.*
- e. *Where Trustees provide greater than one choice the Trustee is obliged to provide the education.*
- f. *Because the Government has introduced the choice environment they are also responsible to provide the education to members so they can make a more informed choice.*
- g. *We contend that a smaller number of investment choices provide the best options for members to make a sensible choice in the face of information overload.*
- h. *Given the changing investment environment there is a need for trustees to explore new techniques which can perhaps reduce the volatility of returns thus reducing the dissonance of members who see their returns in a single year produce negative returns.*
- i. *There is a need for Trustees to ensure that members understand the nature of the fund's MICs so that informed decisions are made.*
- j. *The emphasis for trustees is to ensure that the portfolio MIC, developed by the fund, are adequate for the spectrum of members within the fund; they are monitored regularly and that trustee concentrate on the after-tax returns of managers which will maximise the benefits of members not necessarily the managers with the largest returns. This is especially so in the Alpha transportation world where every transaction is a taxable event. Trustees also need to consider the absolute costs of investment management as a reflection of these after tax returns.*

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

- a. *From our experience, self managed funds have grown where businessmen have or can create synergies between the operating company and their superannuation fund when, for example, the primary business property is owned by the SMSF and rented to the operating entity.*
- b. *Where people who have long established business skills, who access property and investment strategies with their own proprietary knowledge in their normal business activity, these people are more comfortable doing those investment themselves than placing their funds into the hands of an external manager who are charging a fee for an activity which they believe they can do themselves.*
- c. *Also where members think they can beat the managers, especially after a market downturn and frequently, in a state of ignorance by those members of the nature of equity markets and unaware of Bill Sharpe's classic paper that evidences that not many managers can consistently beat the market over the long term, SMSF are established.*
- d. *There is a perception that a minimum of \$200,000 is required to seed a SMSF but we dispute these figure (albeit ASIC have been labelled with this advice). Because of our experience in industry and corporate master funds an MER of 0.7% including investment costs is not uncommon. (This includes both investment and administration). Thus the total costs to run an SMSF to be comparable is \$1,400 including Administration, investment, audit, tax returns and opportunity cost of time of the member. In addition an advisor cost typically start at 0.50% p.a. which means the true breakeven benefit to start a SMSF is closer to \$350,000 if we ignore all investment costs.*
- e. *The influence of advisers, of accountants and financial planners whose interests are perhaps contrary to the interest of the members, have recommended the establishment of SMSFs which they administer, audit and sometime invest for the member. It is only with financial education that people can properly assess whether a SMSF is suitable for them.*
- f. *The client's accountant, to avoid entry fees in Life Office products, frequently establishes a SMSF.*
- g. *We are doubtful that on average, these funds perform as well as the medium managed fund on an after-tax return and cost efficiency basis.*
- h. *APRA data indicate that the cash allocation of a standard cash fund is clearly inconsistent with a Balanced fund thereby many DIY self investors get poor advice or are not running their funds optimally.*

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

- a. *Any periods of market declines has the joint pincer impact of depressing the market values of superannuation portfolios (thus reducing the assets to support the required vested benefits of a defined benefit superannuation*

fund) and it also puts pressure on actuarial recommendations for employer to increase contribution levels in a time of market decline- especially after a couple of years of market downturns. This combination of factors together with the move to forfeit salary to Award Superannuation as an accumulation account and the establishment of mandatory SG contributions set a framework for a reduction in DB Funds.

- b. The clearly advertised settlement by Westpac's of sharing the defined benefit surplus was a further incentive by Employers to access the reserves in the Defined Benefit Funds to improve their financial status, but to top it off, the new International Accounting standards now require Companies to report their actuarial liabilities in their public accounts.*
- c. International standards for the reporting of liabilities to fund pensions in Europe, for example, requires the application of an actuarial base to underpin the liabilities with fixed term investments which dramatically increased the liabilities of those pensions as the inflation gap dropped to a real 1.5%.*
- d. No Australian company would consider taking up these liabilities in their balance sheet if they could avoid it.*
- e. As an aside, we understand from work undertaken by Professor Margaret Steinberg that with the incorporation of a USA's company's health liabilities, which is mooted to be taken up in the near future, it is anticipated that many companies will have negative worth if that liability is taken up on a conservative funding basis.*
- f. We believe that most Employers are now no longer willing to take or accept the:*
 - i. Investment risk to provide the benefit,*
 - ii. The salary escalation risk of employee remunerations,*
 - iii. The accounting risk of an on balance sheet liability over which they have no control,*
 - iv. Complexity of explanation the fund design including the SG*
 - v. Determination of the new tax free components under the proposed rules,*
 - vi. The difficulty of splitting and access to marriage breakdowns*
 - vii. And the raft of other factors like actuarial costs, reporting separation of investments for DB and Accumulation etc.*
- g. The DB fund does not provide the portability requirements of a changing work environment with people changing jobs and undertaking part time work. The Defined benefit - calculated as some Benefit multiples X service X salary X vesting characteristics based on service and category become a complete nonsense for a portable workforce with changing salaries and an intransient work place.*

9. Cost of compliance.

- a. Some of the required reporting is complex and can be misinterpreted by the members,*

- b. *Compliance must be focused on cost efficiently assessing the management and operations of the fund to ensure asset protection for the long term benefits of the members.*
- c. *We believe it is costly and it doesn't provide good value*
- d. *Legal differing opinions on ambiguity increases the effort for sensible reporting and presentation to members*
- e. *Funds now require legal and compliance teams to ensure compliance with SIS, FSR, ATO, Trust Law, Corp Law, SG law etc*
- f. *All costs are ultimately born by the members so we are anxious to focus on compliance, which is relevant and necessary for the sound management of the fund.*
- g. *Funds now incur Trustee training costs, which are mandatory under RSE licensing – an added cost but a necessary requirement to ensure competency of trustees.*
- h. *Some of the regulators have taken an extreme and narrow interpretation of disclosure legislation. Either the Governments initial intentions have not been reflected in the legislation or the regulators have adopted an interpretation contrary to Government's intention. This has, in part, been addressed by some of the legislative amendments in the FSR regime however there is still work to be done. While difficult to quantify the overall cost of implementation of FSR to the members would be high.*

10. The appropriateness of the funding arrangements for prudential regulations

- a. *APRA levy is met by the registered funds on a general user pay basis with cost efficiencies for the larger funds.*
- b. *Should the funds be given some say in the policy management of the regulator since they are funding it, by say, the appointment of a Management Committee to give direction to the scope and direction of the policy implementation?*
- c. *We believe that a single regulator will provide greater operating and control efficiency by eliminating duplication and taking a more holistic approach to the assessment process.*

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

- a. *Size belies efficiency and generally reduces cost; it is additional complexity that increases costs.*
- b. *If the objectives for promotional advertising are to attract members, retain members and so provide greater size/cost/servicing efficiency then all members enjoy those efficiencies and all costs should be born by them.*
- c. *Is the question being asked: "Should Superannuation Fund **have the right** to undertake promotional advertising" In a free economy and with advantages for existing members to attract additional members, greater contributions, and greater cost and servicing efficiency it begs the questions why would the Government even consider restricting such freedom. This is especially so as the Trustees are endeavouring to educate*

members and provide them with information about their fund. To illustrate their operating costs and their mutual ownership and resulting design efficiencies to provide for their retirement benefits.

- d. In a recent report in the Courier Mail it was reported that the average Queensland resident spends 20 minutes a week on his football tips and only 5 minutes a year on his superannuation statement. Maybe then Host Plus and the Melbourne Storms should be the venture for education of super!!!*

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

- a. The sponsors of Industry funds, under SIS, are the Employer and Employee associations who have established the funds for the purpose of providing an environment in which the single objective is to maximise the benefits of the members- be they employees or employers. With that brief the trustee are obliged to ensure that the members' benefits are protected and managed with the greatest cost effectiveness.*
- b. This means that the servicing, investments and administration is conducted with the objective of controlling costs and improving servicing for the benefit of the member. Hence the term "not for profit" implies that the management entity seeks no return on capital profits for the promoters and profits from administration, insurance, investment reserve belong to the member and while they may be held in reserves, those reserves belong to the members and are paid to them.*
- c. This supports the statement that "all profits go to the members".*
- d. In some cases not-for-profit funds have established wholly owned entities to provide administration investment advisory and other financial services. In such cases the profits from these activities is owned by the members of the fund and not external shareholders.*
- e. With freedom of choice most people can generally arrange their contributions to be paid into any fund they nominate. And in doing so they can select those funds with inherent design structures (large Employer and Industry Funds) where the philosophy of cost minimisation, sound management and investment ensure that returns credited are the highest possible for the benefit of the member.*
- f. Proven performance by Industry funds is clearly reported by independent reviewers of Fund's performance and those margins of excess performance reflect that the funds operate on a "not for profit" basis.*
- g. We believe that not-for-profit funds have a role to play in the landscape of investment structure in the broader Australian Environment. Were it not so AMP, National Mutual/AXA, MLC, Bank of Queensland etc would not be commercial entities today since they all started life as Mutual Funds or Building Societies established for their members.*

13. Benchmarking Australian against International practice and experience

- a. **Benchmarking** against other international countries is difficult. For example Singapore had/ has high contribution levels but this was occurring with very high salary escalation rates, which meant the gap between salary escalation rates, and contribution rates meant the funding efficiency was comparable to Australia. Their capacity to access the benefits for residential purposes means that this becomes an enormous topic but tabled below are our cursory comments on the following topics.
- b. **Taxation equality and efficiency.** Traditional Superannuation taxation Structures provide an EET basis- Exempt in contribution, Exempt in the fund and Taxed on receipt. That EET basis defers the tax collection so recurring current expenditure will not be sourced from the enormous pool of super investments until income is received on retirement where it is taxed in some 30 years time. Thus the Government concession of foregone tax revenue on contributions, will not be repaid for a 30 year period. Australia (we think the only nation to do so) has taken a TTE approach with the introduction in 1988, of a tax on super contributions and income and Capital Gains. Under this structure rebates are provided to offset the tax that would otherwise be payable on pensions or ETP. Under the old basis, generally, retirees with a pension of up to \$35,000 per annum are indifferent between the previous taxed arrangement and the new arrangement of being tax exempt as ADA (Annual deductible amounts) and rebates reduced the tax on the pension. If we consider a very wealthy individual however, who has say \$30m in a fund to meet pension commitments sourced from say, capital gains made prior to the recent restrictions then the pension savings as completely non-taxed non-reportable pensions means the aggregate tax saving for this individual would be over \$20m for the remainder of their life. This concession flies in the face of overseas structures where people with the greatest resources pay a greater proportion of the tax. It also flies in the face of the underpinning progression in income tax scales which were first introduced in the UK by William Pitt Jr in 1790 and carried forward in some form by all countries.
- c. **Levels of retirement benefits.** The new contribution rules allows greater flexibility for contributions but the mandatory contributions of 9% of salary in Australia for people in FULL TIME employment means that the final retirement benefit will be, after 35 years of contribution, some 30-35% of projected salary at retirement. That projection assumes a real long term after-tax and expenses growth rate of 4.8% with admin cost of 0.22%. The projected end benefit is probably lower than the Scandinavian countries but ranks fairly well on a comparison basis.

- d. **Adequacy for all people.** Government is responsible for setting the policy on the quantum of the concessional benefit that people can enjoy in retirement. To have no limitation on the benefit other than on the contributions levels that limit deductible and post tax contributions seems contrary to overseas experience. What level of retirement benefits does the government wish to give concessions to allow people to fund their retirement? Once those caps are reached then perhaps caps should come on to avoid the distortion of people bucketing resources into Super for the primary advantage of tax concessions and not necessarily their retirement?
- e. **What do we want for Australia?** Our inherent natural resources and our culture of fairness should set standards for the vision of what the country should encourage people to provide for themselves via mandatory contributions and concessions for those who wish to provide more. These decisions should be made by assessing our ability to maintain a sustainable funded benefit for all Australians irrespective of circumstance. We acknowledge that a portion of retirement funding will be provided via age pensions but every endeavour should be made to encourage - or mandate -superannuation savings for a fair and equitable Australia.

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

- a. All APRA Superannuation fund are contributing to cover events of fraud. So, maybe all employers should have to contribute to a fund to protect against insolvency of an employer. Ansett springs to mind.
- b. There needs to be a tightening of the controls on contributions made to the fund for employees. Based on quarterly payments, it can be up to six months before a member becomes aware that contributions have not been made. This grossly disadvantages the employee and could terminate standard insurance cover to the detriment of the member and his family. The collection of the SG amount needs to have tighter provisions and penalties akin to misappropriation, as a portion of this benefit was foregone employees salary.
- c. **We believe members need monthly reports to confirm that contributions have been paid.**

15. Any other relevant matters.

Adequacy of super- As servants of the people we question the situation that exist that Politicians get 15% increase when the constituency that pays the taxes get a 9% contribution or less. A contribution of 15% over 35 years provides a pension of approximately 50% of retirement salary. The workplace migration to part time and casual employment means that there are potentially large numbers of people who, because of salary levels, are excluded from the superannuation environment. **We believe that contribution levels should be set at 15% for all employees.**

We believe that resident Australian under any employment arrangement should have superannuation contributions made on their behalf. The tax-file rules means that tracing can be more systematic than now possible. We are yet to see the impact of the current IR legislation on the adequacy of retirement savings

We believe the level of co-contributions should be increased for lower salary levels, and the threshold extended at the upper range and provide equivalent government contributions for a member's voluntary up to a cap of 3%. This would provide a 15% contribution rate.

a.

We believe that Industry funds should be given pseudo public offer status as they are tightly controlled and managed operations that provide competition between themselves and the market for the best retirement products

Contributions levels? – There seems to be a naïve understanding by Australian legislators, of the household's organic cash flows. Houses have to be purchased, or rented, children educated, and all of these costs occur in the first 25-30 years of employment. The incapacity to obtain relief for these expenses means a focused emphasis to pay off non-deductible home loans and educate children to the detriment of discretionary super savings. Farmers with highly volatile income streams also need to be given concessions to allow contributions thresholds to reflect their unstable financial situation. Take the current plight of farmers for example where many, in the spreading drought belts, will have no capacity to make any contributions to super this year or in the foreseeable future with climate change impacts. For families that have committed themselves to bringing up children they also need concessions, replicating and extending the current transitional contribution rates for 50+ people to contribute at higher rates to 2012.

We believe that the contribution concession for people aged 50+ needs to be extended into the future past 2012. This will allow those people, whose resources have covered the natural liabilities of family demands, or whose income is highly volatile as a result of weather patterns or circumstance, to contribute at higher rates in their later life after the education of children and the payment of home loans no longer eroded discretionary savings. This is especially so for farmers, who hopefully will be some good years in the last 15 years of their working life prior to 65 to allow them to contribute for their retirement.

Member Protection. Given that Superannuation Guarantee has been in place for some time then there is good logic to now remove Member Protection costs and encourage the amalgamation of accounts. Where these multiple accounts have small balances it forces the members with larger accounts to subsidize the fees rightfully by the other members of the fund. ***We believe that consideration be given to remove Member Protection.***

**All of the funds have authorised W N Hughes, Director of ESI Financial Services,
SPEC(Q)
Signed**

W N Hughes

**On behalf of the following funds
SPECQ, QIEC, CLUB, AUST(Q), ISPF**