AUSTRALIAN HOTELS ASSOCIATION

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31 October 2006

The Committee Secretary
The Parliamentary Joint Committee on Corporations
and Financial Services
Parliament House
Canberra ACT 2600

Dear Sir

RE: Inquiry into the Australian Superannuation Industry.

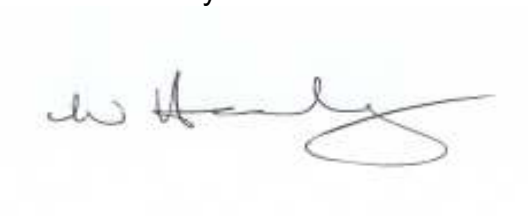
The Australian Hotels Association (AHA) is recognised as the leading hospitality and tourism industry body in Australia. It represents over 8500 pub-style and 3, 4 and 5 Star accommodation hotels throughout the nation.

The AHA welcomes the opportunity to provide a submission to this Inquiry into the Australian Superannuation Industry.

We would like to thank the Committee for providing the AHA with an extension

I look forward to further discussions on this matter. Please feel free to contact me if you would like to discuss any of the issues raised.

Yours sincerely



Bill Healey
DIRECTOR NATIONAL AFFAIRS

The Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into the Australian Superannuation Industry

Submission by the

Australian Hotels Association

October, 2006

1. Executive Summary

1. The current regulation of trustees should continue.

2. The AHA opposes proposed recommendation that all trustees have uniform capital requirements. Excessive capital requirements should not be imposed because of the different nature of trustees and because they would be largely ineffective in dealing with any concerns about systemic failure. In addition, trustees of industry funds are subject to specific and detailed regulation under industrial relations rules, meaning the argument for additional superannuation regulations is weak.

3. The AHA does not support any proposed recommendation that all trustees should be public companies; It would serve no useful purpose and would impose significant costs on trustees with no perceivable benefit.

4. The AHA believes that advice is an essential component in superannuation and believes the sole purpose test should be extended to include financial planning advice in matters other than a member's interest in the fund if it relates to retirement benefits. The AHA retains concerns that it is very hard for many businesses, particularly small businesses, to distinguish between information and advice provided to employees. The AHA supports reduced regulation of advice including exemptions for employers acting in good faith.

5. The AHA believes that under "employee choice" advertising is a legitimate expense of the fund, and therefore to its members;

6. The concept of "Not for profit" and "all profit goes to members" are legitimate concepts that should be supported by the Federal Government as they are in the interests of superannuation members and legitimate competitors to retail superannuation funds.

Other issues

7. The costs of complying with the 9 percent superannuation guarantee are significant for employers. This compulsory impost should not be increased and increases in exemption thresholds should be implemented.

8. There is insufficient data on the loss of superannuation entitlements due to employer insolvency. Further research is required. At this stage, we do not support the extension of the government's GEERS scheme to provide for unpaid superannuation contributions.

2. Background

The Parliamentary Joint Committee on Corporations and Financial Services is undertaking an Inquiry into the Australian Superannuation Industry.

The Committee will inquire into the structure and operation of the *Superannuation Industry (Supervision) Act 1993* and the superannuation industry to ensure that it provides an efficient, effective and safe regulatory structure for the management of superannuation funds, with particular reference to:

1. Whether uniform capital requirements should apply to trustees.
2. Whether all trustees should be required to be public companies.
3. The relevance of Australian Prudential Regulation Authority standards.
4. The role of advice in superannuation.
5. The meaning of member investment choice.
6. The responsibility of the trustee in a member investment choice situation.
7. The reasons for the growth in self managed superannuation funds.
8. The demise of defined benefit funds and the use of accumulation funds as the industry standard fund.
9. Cost of compliance.
10. The appropriateness of the funding arrangements for prudential regulation.
11. Whether promotional advertising should be a cost to a fund and, therefore, to its members.
12. The meaning of the concepts “not for profit” and “all profits go to members.”
13. Benchmarking Australia against international practice and experience.
14. Level of compensation in the event of theft, fraud and employer insolvency.
15. Any other relevant matters.

3. The Australian Hotels Association (AHA)

The Australian Hotels Association (AHA) is recognised as the leading hospitality and tourism industry body in Australia. It represents over 8500 pub-style and 3, 4 and 5 Star accommodation hotels throughout the nation.

Our members provide a range of accommodation and hospitality services that are a key component of the tourism product mix. These are dependent on, and contribute to, the broader range of products and services that combine to provide the tourism experience.

The AHA is a 50% owner of the HOST**PLUS** Superannuation Fund (HOST**PLUS**) which is the industry superannuation fund for the hospitality, tourism, recreation and sporting industries.

As at the date of this submission, HOST**PLUS** currently has approximately 726,000 members nationwide and approximately $5 billion in assets under management. HOST**PLUS** has 9 directors, 3 appointed by the AHA, 3 appointed by its member sponsor organisation and 3 independent directors.

4. The performance of industry funds

The AHA believes the performance of industry super funds confirms that the current regulatory arrangement provide an efficient, effective and safe regulatory structure.

Independent research recently undertaken by the research house SuperRatings, demonstrates that industry funds out-perform retail master trusts. SuperRatings found:

- For the year to 30 June 2006: Seven of the top ten public offer funds, in terms of net returns (returns less fees and tax) are industry funds (eight if you count Telstra, which is a corporate fund).

- For the three years to 30 June 2006, Seven of the top ten public offer funds, in terms of net returns (returns less fees and tax) are industry funds (eight if you count Telstra).

- For the five years to 30 June 2006: Ten of the top ten public offer funds, in terms of net returns (returns less fees and tax) are industry funds.

5. Key Issues for Submissions to Superannuation Inquiry

The AHA submission focuses on five of the fifteen terms of reference (TOR) given to the inquiry. The five are:

- Whether uniform capital requirements should apply to trustees (TOR 1)
- Whether all trustees should be required to be public companies (TOR 2)
- The role of advice in superannuation (TOR 4)
- Whether promotional advertising should be a cost to a fund and, therefore, to its members (TOR 11)
- The meaning of the concepts “not for profit” and “all profits go to members.” (TOR 12).

5.1 Whether uniform capital requirements should apply to trustees

Under the SIS Act and the APRA RSE Licensing regime, trustees of non-public offer funds do not have to satisfy any capital or net tangible assets requirements.

Trustees of public offer super funds must hold $5 million in net tangible assets and/or approved guarantee.

Industry funds do not have access to shareholder capital. The initial share capital is paid up by the sponsoring associations in equal numbers.

Any requirement that shareholders of non profit industry funds be required to collectively put up $5 million in capital to underwrite their industry fund would mean they would receive no return on this new capital or force them to cease to operate on a not for profit basis.

In order for industry funds to raise the capital, their trustees would have to seek capital contributions from their shareholders.). A $2.5 million contribution to Hostplus would create financial hardship for our organisation given that our core business is not running a superannuation funds.

HOST**PLUS** was established in 1988 as the industry fund for the Hospitality and Tourism Industries under the relevant Federal and State awards. This has continued to date. The Fund has operated on a "*not for profit basis*" therefore we have never been paid a dividend. If there was a requirement for the AHA to put up this capital we would require a return and the Fund could no longer operate on a "*not for profit basis*". This would be to the detriment of HOST**PLUS** members who would receive lower retirement savings over time.

The Inquiry needs to consider if the reasons for introducing capital requirements are relevant to industry funds. These include:

- To provide evidence of the commitment of the trustee to their superannuation business.

Shareholders in Industry Funds are not engaged in Superannuation for a commercial return. They seek to advance and protect the broader, long term interests of their members and the industry in which they operate. Our commitment is shown by providing board members, the risk to our organisational reputation by endorsing the fund, providing access to membership and workplaces, and by actively marketing of the fund.

- An incentive upon the trustee to ensure that the super fund is well run

Trustees of super funds have to undertake their responsibilities in accordance with the significant duties imposed under the SIS Act and principles of trust law (which are appropriately onerous). These legal duties, which impose personal liability in the event of breach, are a more effective and appropriate mechanism to ensure that super funds are well managed.

- A buffer against risk

The typical industry fund business model reduces risk by outsourcing core functions. This delivers economies of scale and access to expertise at a lower cost to members. Most industry funds outsource their administration, investment, asset consultancy and insurance functions. As such, any substantial error that causes loss to members is likely to be the result of an error made by an external party (either administrator, custodian or asset consultant) and covered by their insurance which is required in material contracts between the fund and these service providers (pursuant to the APRA Outsourcing Operating Standard). An error caused by the fund would be protected through trustee liability insurance.

Recent changes to the regulatory environment, through the introduction of the APRA licensing regime, has required that industry super funds address risk management and adequacy of resources in great detail. The APRA Licensing regime therefore renders unnecessary any further changes to capital requirements.

The AHA believes that making capital requirements uniform would impact on both industry and corporate super fund sector. If more onerous capital requirements were

imposed, it is likely that funds would be wound up or would be forced to change into a commercially operated basis so that a return could be paid on capital. Rather than improving the situation for fund members, these changes to capital requirements could result in reduction in competition in the industry, which would not benefit members.

The AHA notes that stakeholders in industry super funds strongly oppose uniform capital requirements and industry bodies, including the Association of Superannuation Funds of Australia (ASFA) recommend that the status quo should be preserved and

5.2 Whether all trustees should be required to be public companies

The AHA does not support any proposed recommendation that all trustees should be public companies.

The AHA believes that the status quo provides adequate protection for superannuation fund members and having trustees change their current corporate structure adds no real benefit.

A review of the *Corporations Act 2001* reveals that the only section that would have any bearing on supporting the proposal is section 195 whereby a director of a public company may not be present in a director's meeting if they have a material personal interest. Otherwise all current requirements in regards to directors duties apply to directors of proprietary companies.

As most trustees, if required to be public companies, would be unlisted public companies, the same access to capital requirements and issues will remain.

Particularly we address the following issues which differentiate public companies from proprietary companies:

- **Requirement that a public company hold an Annual General Meeting (section 250N of *Corporations Act*)**

This requirement is unnecessary for trustees of superannuation funds if they conduct operations on behalf of superannuation fund members and not for the benefit of shareholders. This is particularly the case for industry funds which act on a "not-for-profit" basis.

- **Convenience of proprietary company member resolutions as opposed to public company requirement of a formal meeting of members (section 249A)**

Shareholders of proprietary companies can conveniently pass member resolutions in place of holding a formal meeting of members by signing a statement indicating they are in favour of the motion. Given that most trustee companies have only a nominal number of shareholders the requirement of holding a formal meeting of members to pass member resolutions is inconvenient and unnecessary.

- **The requirement to prepare annual financial reports and directors reports**

The requirement of public companies to prepare annual financial reports and director's reports (section 292(1)) is unnecessary where a trustee is acting purely in the capacity as

trustee of a superannuation fund because the company will most likely hold no assets of its own.

The Corporations Act already requires trustees to prepare and send to members annual reports in relation to the operations of the superannuation funds for which they are trustee as well as annual member benefit statements indicating how individual member's benefits are performing in the fund.

Accordingly, in our view, the present exclusion of the requirement of small proprietary companies to prepare financial and directors reports should be maintained for trustees.

- **Requirement to appoint an auditor**

Superannuation funds are already required to be audited regardless of whether the trustee is a proprietary company or public company.

- **Member approval for related party benefits**

The requirements of Chapter 2E of the Corporations Act in relation to related party transactions for public companies is unnecessary for trustees of superannuation funds.

Section 109 of the SIS Act already requires that trustees and investment managers of superannuation funds invest on an "arms length" basis which means transactions are already exempt from the related party benefit rules under the Corporations Act because "arms length" transactions are specifically excluded from those rules (section 210 of the Corporations Act).

The application of these laws would therefore largely duplicate regulation already provided for in the SIS Act.

Additionally in our view, if accountability for related party transactions is required of trustees it should be to members of the fund rather than shareholders of the trustee company.

Accordingly the related party transaction laws applicable to public companies are largely irrelevant and impractical for superannuation fund trustees.

- **Public company requirements may be inconsistent with SIS Act requirements**

The requirement that a public company have at least three directors may conceivably be inconsistent with the equal representation rules under the SIS Act for some funds which may wish to have only one employer and one member representative on a trustee board.

Additionally the fact that section 203D of the *Corporations Act* 2001 gives shareholders of public companies the right to remove directors by an ordinary resolution of shareholders regardless of what the company's constitution states together with section 107(2)(a)(ii) of the SIS Act which requires that generally member representative directors of a fund trustee can only be removed by the same procedure by which they were appointed causes concerns for present procedures used to elect member representative directors of trustees.

Specifically if superannuation fund trustees are required to be public companies section 203D will effectively require that the appointment of member representatives be by ordinary resolution of all of the shareholders of the company which is contrary to many existing trustee constitutions which allow a quota of member representative directors to be nominated by unions ,other member representative bodies or elected by the fund members and not by the shareholders as a whole.

- **Requirement for public company office to be open to public**

The requirement that a public company generally have its registered office open to the public between the hours of 10 – 12 pm and 2 – 4 pm each business day is an unnecessary inconvenience for superannuation funds which are not public offer funds such as many corporate funds. As such funds have a restricted membership only generally associated with the principal employer of the fund they should not be required to be open to the public.

5.3 The role of advice in superannuation

The AHA accepts that advice is an essential component in superannuation.

It can take many forms, whether educational information provided by the Trustee to its members in fund publications and websites or specific personal advice provided by financial advisers to their clients.

The AHA is in favour of funds being able to provide appropriate advice notwithstanding the risk that advice will not be truly independent. This is no different from other financial planning companies.

Financial advice should be funded by fee for service rather than the charging of commissions on superannuation contributions or member's benefits.

The AHA supports the change in the sole purpose test in the SIS Act to clearly allow members to pay for advice out of their superannuation account balances in relation not only to the superannuation interests of members but other financial products if they relate to a person's provision of retirement benefits.

In this way superannuation funds can provide personal advice to their members without the need to either outsource the advice or establish separate entities (albeit wholly owned) to provide financial planning services. Fees should be only on a fee for service basis as being consistent with the need to preserve retirement incomes.

5.4 Whether promotional advertising should be a cost to a fund and, therefore, to its members

Since the advent of Choice of Fund, industry super funds have a legitimate need to undertake marketing campaigns to protect and grow market share.

The following points support the rationale for advertising:

APRA clarified in early 2005 prior to the introduction of choice that expenditure on advertising by a super fund was consistent with the sole purpose test.

Advertising in the current competitive environment is essential in order to retain and acquire members and participating employers. Retention and acquisition of this business is key to retaining/building scale, which impacts significantly on the unit costs per member of running a super fund. If membership is lost or not built, unit costs increase.

Advertising is also a legitimate method by which industry funds can educate their existing membership.

The amount that industry funds spend on advertising is much less that the amounts spent by retail funds and financial planners or institutions. In the monitoring of advertising undertaken by ASIC from July 2004 to November 2005, industry funds represented only 7% of advertising, whereas financial planners dominated with a 38% share of the market and retail funds held a 22% share.

The AHA therefore believes that advertising is a legitimate cost to a fund and therefore to its members.

It is clear that the legal position of the sole purpose test set out in section 62 of the SIS Act is that advertising, in whatever format, is a legitimate expense of the fund. It is simply another matter of the operation and administration of the fund for the trustee to manage. Accordingly a trustee should appropriately manage advertising, allocate appropriate funding whilst still acting in the best interests of members.

Advertising is an essential component of competition which is a fundamental cornerstone of the current Federal Government. HOST**PLUS** should be able to compete in the open marketplace on equal footing with other superannuation providers such as retail funds. The only way a fund like HOST**PLUS** can do this is to utilise fund assets (as previously described in the capital adequacy section of this submission). It is a legitimate business expense.

Removal of the right of an industry fund like HOST**PLUS** to advertise or to use fund assets to advertise, would in our opinion, be a breach of Part IV of the *Trade Practices Act* 1975 and a restraint of trade and lessening of competition.

HOST**PLUS** does not have a distribution network of financial planners like the large life offices. HOST**PLUS** can only rely on advertising for distribution of its products. Traditional protections such as the Award system are no longer relevant or useful to the fund after the advent of the Choice of Fund legislation.

The advent of the portability provisions in the SIS Regulations are another factor that justify the need for Trustee to advertise in order to attract new members and more importantly to retain existing members.

Retention of members means stabilisation of costs and growth over time of funds under management. Scale is important as it gives the trustee the buying power to reduce costs over the long term to members by way of lower investment management costs and lower administration costs. Lower costs means increased retirement savings for members and less reliance on any aged pension and social security facilities. Loss of members will lead to higher costs for members.

The last point to note is that retail funds already make members indirectly fund “advertising” expenditure in the form of higher fees.

In summary advertising serves four purposes:

Firstly, it is a mechanism to attract new employer sponsors to choose the fund as its default fund under the Choice of Fund legislation.

Secondly, it helps retain members which allows the retention (and building) of scale which in turn reduces member costs.

Thirdly, reduced member cost means increased retirement savings which is a cornerstone of the Federal Government. This leads to lower demands on the social security system.

Fourthly, advertising also allows for member education about existing benefits, new benefits and saving for retirement.

5.5 The meaning of the concepts "*not for profit*" and "*all profits go to members*"

The AHA supports the concept of "*not for profit*" and "*all profits go to members*". That is the ethos and intent of HOST**PLUS** and the way it treats its members.

"Not for profit" and "*all profits go to members*" are simple concepts that the Federal Government should support . As stated above the Choice of Fund legislation has produced a new environment in which superannuation fund trustees have to compete in the marketplace. The terms relate not only to industry funds that grew out of the Award system but to corporate superannuation funds and public sector superannuation funds.

What does "not for profit" mean? It means that a trustee can make a surplus from the service that it provides, but this needs to be applied for the benefit of members . For example, any surplus of funds retained (after applicable operational expenses) from fees deducted from member accounts are retained by the trustee and reinvested into further services for members or to enhance the fund net earning investment return allocated to members Thus all profits go to members. In the case of industry funds, as explained previously, there is no dividend that is paid to the Trustee's shareholders. Dividends under the Corporations Act can only be paid from profits. The "profits" from operations are retained/reinvested in the fund for the benefit of the members. Therefore the trustees of industry, separate corporate funds (as distinct from corporate sub-plans in a retail master trust) and industry funds can correctly state that they are "not for profit" or "all profits go to members" without being in breach of the Corporations Act provisions that regulate advertising and misleading and deceptive conduct.

As members now have adequate choice and unlimited access to licensed financial planners they can choose whatever type of fund they wish to belong to without restriction. This is the essence of competition. Accordingly, the AHA does not support any attempt to restrict or deny the "not for profit" fund sector in the Australian market.