11th July 2003

The Manager
Prudential Policy – Superannuation and Insurance Unit
Financial System Division
The Treasury
Langton Crescent
CANBERRA ACT 2600

Dear Sir/Madam

EXPOSURE DRAFT BILL FOR CONSULTATION – SUPERANNUATION SAFETY AMENDMENT BILL 2003

The Institute of Actuaries of Australia (IAAust) appreciates the opportunity to provide the following comments on the exposure draft of the Superannuation Safety Amendment Bill 2003 (the Bill), as it proposes to amend the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

A. Comments on proposed amendments under Schedule 2 of the Bill

Section 129

The effect of the proposed amendments to section 129 of the SIS Act would be to require the actuary or auditor to report any breach of the SIS Act which is discovered while conducting an actuarial or audit function under the SIS Act, to the Regulator, unless there is an honest belief that the opinion is not relevant to the performance of the actuarial or audit function (as well as the existing requirement to inform the Trustee).

Reporting to the Regulator would therefore be required even if the breach is minor or if it has been immediately rectified. This new requirement would not necessarily improve the security of members' benefits.

IAAust recommends that the proposed amendments to section 129 of the SIS Act be amended so that reporting to the Regulator of a breach of the SIS Act is only required if the actuary or auditor is of the opinion that the breach is material to the performance of the actuarial or audit function.

Section 130

The effect of the proposed amendments to section 130 of the SIS Act would be to require the actuary or auditor to report any unsatisfactory financial position (UFP), or their opinion that a fund is about to enter a UFP, which is discovered, or determined, while conducting an actuarial or audit function under the SIS Act, to the Regulator (as well as the existing requirement to inform the Trustee).

Reporting to the Regulator would therefore be required even if the UFP has been immediately rectified. Once again, this new requirement would not necessarily improve the security of members' benefits.

IAAust further recommends that the proposed amendments to section 130 of the SIS Act be amended to only require reporting of a UFP to the Regulator in the event that the UFP is material or is likely to become material and is unlikely to be immediately rectified.

Proposed section 130A

Proposed new section 130A of the SIS Act provides that an actuary or auditor may give information about an entity or the trustee of the entity to the Regulator if it is considered that this will assist the Regulator in performing its duties. The proposed new section 130A also introduces protection for any such "whistleblower".

Section 130A is too broad. Consideration should be given to restricting the proposed section to situations where the actuary or auditor has concerns about the security of members' benefits or the prudential management of the fund. In this regard, IAAust considers that there should be consistency in regulatory provision for reporting requirements to the Regulator across the Life, General and Superannuation industries. Please refer to the section below concerning reporting requirements under the *Life Insurance Act 1995* and *Insurance Act 1973*.

Proposed new section 130A provides the actuary to a superannuation fund with a discretion as to whether to report certain matters to APRA. IAAust has concerns about the lack of clarity concerning the legal position of an actuary who does not provide information to the Regulator, and if an adverse situation develops in relation to the fund. IAAust submits that such uncertainty would not be present if proposed section 130A is amended to be consistent with corresponding reporting provisions under the *Insurance Act 1973* or the *Life Insurance Act 1995*.

Proposed section 130A may have the effect of reducing the reliance placed on actuaries. Trustees are at liberty to only use actuaries for statutory functions. In order to minimise the possibility of reporting under section 130A, trustees could elect to keep the actuary at "arms length", and use a superannuation consultant, or other individual to advise on the day to day running of the fund. Actions along these lines would hamper the actuary's ability to adequately oversee the management of the fund and would most likely be contrary to the intention of the draft Bill.

To avoid this situation, if proposed section 130A is not restricted as suggested above, it may be appropriate to consider the introduction of an "Appointed Actuary" role for all funds, or at least those with a defined benefit component or a credited interest rate

which does not directly reflect the actual investment return for the same period (a smoothed credited interest rate). This role could be defined in such a way to require the actuary to be involved in the regular supervision of the fund, rather than just constrained to certain statutory functions.

Alternatively it may be appropriate to broaden proposed section 130A so that it applies to anyone advising a fund or the trustee of a fund, rather than just the actuary or auditor.

B. Comments on proposed amendments under Schedule 5 of the Bill

Proposed section 20B

The "defined benefit member" definition should specifically exclude death and total and permanent disablement benefits to avoid catching accumulation members.

Proposed section 130C

Proposed section 130C will require an actuary to a defined benefit fund to notify the Regulator and trustee if:

- the person forms the opinion that the trustee of a defined benefit fund, or an employer-sponsor of the fund, has failed to implement an actuarial recommendation that relates to contributions to the fund by the employer-sponsor and that is contained in:

    (i) a funding and solvency certificate relating to the fund; or

    (ii) a report of an actuary obtained under the regulations or in accordance with a requirement under the regulations; and

- the person formed the opinion in the course of, or in connection with, the performance by the person of actuarial functions under this Act or the regulations or the *Financial Sector (Collection of Data) Act 2001* in relation to the entity.

Again, this would discourage trustees from using actuaries in between statutory functions where a recommendation has not been implemented. Interestingly, the actuary may make "mid-term" contribution recommendations and there is no need for the actuary to tell the Regulator if these are not implemented.

Proposed section 130C appears to require the actuary to report to APRA if the employer pays more than recommended, or if the recommended contribution program is revised post-review, or if a month's contributions are slightly late or slightly short and the funding and solvency certificate needs replacing. IAAust expects these outcomes are unintended, and therefore recommends that proposed section 130C be amended so that reporting is only required in the event that the action, or inaction, is deemed to be adversely material.

C. General comment on consistency with other APRA regulated entities

Section 98 of the *Life Insurance Act 1995* and sections 49 and 49A of the *Insurance Act 1973* set out certain reporting requirements for actuaries in the life insurance industry and general insurance industry. Broadly, reporting is only required in respect of contravention of the law and/or matters of materiality to policyholders' interests, or if the Regulator has made a request for information. IAAust recommends that a consistent approach be adopted for the superannuation industry.

D. General comments on investment and funds management issues

The major sections of the draft Bill which focus on investment and related risk are the requirements for a Risk Management Strategy (relating to the activities of the trustee) and Risk Management Plan (related to the superannuation entity). Sections of the draft Bill allow there to be overlaps between these two documents. The separation into two documents may lead to confusion in trying to segregate risks between the two. It would be preferable to either have one document relating to risk control by the trustee of one or more entities which they are responsible for, or to be more specific in the Act on the separation of types of risk to be covered by the Risk Management Strategy and Risk Management Plan.

There is detailed specification of risk and investment obligations of trustees in section 52 (f) and (g) of the SIS Act. There is widespread practice for trustees to have in place an Investment Policy Statement for each superannuation entity which documents the procedures and guidelines followed to implement investment strategy and monitor investment risks. It would be preferable to formally require an Investment Policy Statement (or Investment Management Plan) for each entity in Regulations relating to section 52 and to recognise this if consideration is given to a single Risk Management document under proposed amendments. This approach further strengthens the view above regarding the need for only one new document.

If the proposal to have only one Risk Management document is not adopted, then IAAust recommends that proposed section 29Q(2)(a) be amended to specifically include the procedures taken by the trustee to meet the obligations under section 52 of the SIS Act. For example, proposed section 29Q(2)(a) could be amended to read "identify the risks taken into account in meeting the requirements of section 52 for formulating and giving effect to an investment strategy".

Risk Management Statements currently exist for superannuation funds. They cover only a narrow area of risk in relation to the use of derivatives. Trustees complete these documents by reference to more detailed statements of derivatives use and risk control obtained from investment managers. It would be preferable to abolish the need for trustees to complete the existing Risk Management Statements and instead to:

- consolidate Part A Risk Management Statement style requirements (as specified in APRA Superannuation Circular No II.D.7) into the single consolidated risk/policy document referred to above; and

- recognise Part B Risk Management Statement obligations (as specified in APRA Superannuation Circular No II.D.7) within the financial services licensing

provisions of the Corporations Act 2001 for investment managers (to the extent that they are not already covered).

IAAust would be willing to participate in an industry working group to assist in resolving these inconsistencies and in fulfilling the objectives of the Government in enhancing the attention given by trustees to investment risk management of superannuation funds and the operations of the trustee.

IAAust would be happy to arrange further discussions on these issues if required. Please contact Catherine Beall, Chief Executive on (02) 9239-6106 should you require further information or wish to arrange a meeting.

Yours sincerely

Chris Lewis
President