

Attachment A

SPECIAL FEATURES OF SUPERANNUATION

Superannuation has a number of features that warrant certain designations / changes to the Exposure Draft. This paper briefly describes the general operation of superannuation funds and the Australian Retirement Savings System more generally and points to some areas that will need to be taken into account.

ASFA is separately developing more substantial proposals to address many of the issues raised. As we stated back in 2004 in our original submission to the Attorney-General's Department in response to the call for comments on Anti-Money Laundering Reform *Issues Paper 1, Financial Services Sector*, we believe superannuation is low risk and this should be recognised in any reform.

Contributions to Superannuation

Superannuation contributions can only be made to a regulated complying superannuation fund or Retirement Savings Account (RSA). Funds must comply with the provisions of the *Superannuation Industry (Supervision) Act 1993* (SIS) and the relevant part of the *Corporations Act 2001*. RSAs have very similar rules particularly in relation to accepting contributions and paying benefits.

APRA Licensing Requirements

By 1 July 2006, all non-self managed superannuation fund trustees will be licensed under new APRA licensing requirements. These requirements focus heavily on the management of risk within the trustee and the fund, the management of outsourcing risk and ensuring the fitness and propriety of responsible officers. The Risk Management Strategy and the Risk Management Plan include management of the risk of fraud and theft. Annual audit and reporting to the Regulator, APRA, is required. Seen in this context AML/CTF Program requirements appear too prescriptive and fail to recognise how non-self managed superannuation funds already manage risk.

Self-managed superannuation funds are regulated by the ATO and are discussed separately below.

Superannuation Guarantee (SG)

The *Superannuation Guarantee Administration Act 1992* effectively imposes a requirement on employers to contribute a prescribed amount to a superannuation fund on behalf of its employees. There are strict time limits for payment, so a late payment can trigger significant tax penalties on the employer. This requirement creates a situation where employers often request superannuation funds to open accounts for new employees, so that the SG payments can be made. This is permitted under current law and is common industry practice. The vast majority of contributions flowing into the superannuation system can be categorised as mandated employer contributions.

The Exposure Draft Bill notes the reporting entity “must not continue to provide the service” (eg subclause 33(2)). If this means “unable to accept contributions” this may have an impact on third parties, such as employers, who are required to pay superannuation under the SG or other requirements (such as an industrial award or agreement).

Role of Employers in Providing Member Information

As noted above, often it is the employer, not the member, who effectively opens the account on behalf of the member. For an “employer-sponsored” member, there is no legal obligation for the new member to complete an application form and the fund has up to three months after the member joins the fund to provide the member with a Product Disclosure Statement. There are minimal legal obligations on employers to provide information about the member. A new employer sponsor of a fund is required to complete an application form for themselves and the first member of the fund. After that, it is up to the fund to pursue employers for information about new members. Often employers provide poor, late or incorrect information and in some cases provide no information about new members. Funds expend considerable resources pursuing employers for this information.

Role of a Clearing House

With the introduction of choice of fund a new player has sprung up to make it easier for employers to send contributions to many funds instead of one. There is currently no requirement for a clearing house to be licensed by any regulator. Some are because they also provide services that require a license. The clearing house could be an agent of the fund but may not be. We understand that APRA, ASIC and the ATO are separately examining the implications of these entities from a regulatory perspective.

KYC Requirements

Currently superannuation funds collect data on the member’s name, place of residence, date of birth and tax file number. In transfers they also collect information about the tax status of the various elements which make up the account. This information assists in remaining in contact with the member, including complying with the requirement to report annually to members and the payment of benefits with the correct tax. Information such as place of birth, citizenship and residency has normally not been collected by superannuation funds.

Ability to Open an Account and Make Contributions for Another Person

Not only are employers able to open a superannuation account but the Government has in recent times introduced new flexibilities in terms of who can open an account and make a contribution on behalf of another person. “Spouse accounts” are where the member can open an account and make contributions on behalf of their spouse. More recently, the Government has split the nexus between employment status and contribution status, effectively enabling a person to make a contribution on behalf of any other person.

Superannuation as part of Remuneration

Notwithstanding the break in the nexus between superannuation and employment discussed above, superannuation is still generally seen as a component of an employee’s remuneration. As well, superannuation is often regulated by industrial instruments such as awards and agreements – as well as under common law contracts of employment. The employer may be obliged to make contributions to superannuation or to a particular fund under these requirements.

Preservation

The SIS Act imposes a restriction, through the preservation rules, on a fund's capacity to pay out superannuation benefits to a member. The basic rule is that a person born before 1 July 1960 must be aged 55 and meet other conditions to gain access to their benefits. Persons born after 1 July 1964 must be aged 60. Since 1 July 1999, all contributions made to superannuation funds, including those made voluntarily, are preserved.

Cooling off periods

Under the Corporations Act, contributions to a superannuation product with a cooling off period cannot be refunded to the account holder. They can only be transferred to another superannuation product.

Taking of Benefits

As noted above, preservation effectively means that the money in a superannuation fund is not available to the member until a condition of release is satisfied. In terms of ordinary practice, this is when a superannuation fund would verify the identity of the member so that the benefit can be paid properly.

The conditions of release are set out in Schedule 1 of the *Superannuation Industry (Supervision) Regulations*. Besides retirement, benefits can be paid on the death of the member and when the member becomes totally and permanently disabled.

Benefits can also be paid in instances of temporary incapacity in some funds (must be paid as an income stream) and there is provision for release of money on compassionate grounds (determined by the regulator) and in severe financial hardship cases (determined by the trustee). APRA has released Guidelines for Trustees on Early Release of superannuation Benefits. Briefly, Regulation 6.01(5) requires the trustee to be satisfied on two tests. The member must be in receipt of Commonwealth income support for the last 26 weeks continuously (confirmed in writing by Centrelink) and satisfy the trustee that they are unable to meet reasonable and immediate family living expenses unless the person has reached their preservation age. There is a \$10,000 limit in each 12 month period.

A further condition of release is permanent departure from Australia by a temporary resident on a working visa. Documentation from the Department of Immigration, Multiculturalism and Indigenous Affairs certifies the departure before the benefit can be paid.

Recently, there have been Government measures to provide greater flexibility at the benefit taking stage. The Government has introduced "transition to retirement" rules that permit a person to take a benefit as an income stream after age 55 even though they continue to work.

Closer to retirement many fund members make additional contributions or move money between funds, or commence a pension while still working to achieve a better tax and social security outcome in retirement. The amount of contributions which can receive income tax concessions increases substantially with age and recent comments from the former Commissioner of Taxation have confirmed the legality of reducing tax by commencing an income stream before retiring. Contribution splitting with a spouse has recently been introduced to assist couples achieve better tax outcomes. Currently trustees' concern is that the right person gets the benefit when it is paid or transferred

within the superannuation system and it is difficult to envisage realistic triggers that might alert a fund trustee to money laundering activity or terrorism financing activity at or near this payment stage.

Procedures for Payment of Benefits

Fund members are generally unable to receive payment in cash from a superannuation fund. The withdrawal of benefits from the superannuation system is typically by way of cheque or electronic funds transfer. This applies whether the benefit is paid as a lump sum to the individual, or by means of a regular pension. This generally necessitates the passage of the money through an Australian ADI.

Reporting of Contribution and Benefit Information to the ATO

On an annual basis, the details of total contributions to each individual superannuation account, and the nature of those contributions, must be passed to the Australian Taxation Office under the co-contribution eligibility requirements. As well the payment of lump sum benefits or the commencement of a pension must be reported to the ATO under the Reasonable Benefit Limit (RBL) reporting regime.

Proposed Transaction Threshold Reporting

The Bill proposes that a transaction greater than \$10,000 triggers an obligation to report to AUSTRAC. This is inappropriate for superannuation funds, especially if customer identification were done at the benefit payment stage. According to APRA statistics there were 2.9 million exits from superannuation funds – consisting of benefit payment, transfer and roll-overs. According to Household Income and Labour Dynamics in Australia (HILDA), the average superannuation holdings of an Australian adult is in the \$50,000-\$60,000 range. The tax-free threshold (which represents a modest benefit) for superannuation is \$129,751. \$10,000 is therefore a very low amount for superannuation fund benefits – which are often taken as a lump sum. All but the smallest benefit would be subject to threshold transaction reporting.

Self-Managed Funds

These funds, known colloquially as “DIY funds”, have less than five members and the trustees and the members are generally the same people. Self-managed funds are subject to similar requirements in respect of the role of the trustee, taxation and preservation but are regulated by the Australian Taxation Office rather than APRA. The trustee is not required to be licensed by APRA.

This sector has seen considerable growth. There are over 300,000 self-managed funds that have about \$160 billion in assets (about one quarter of all superannuation assets in Australia). Employees eligible to choose their superannuation fund can now direct their employer to contribute to a self-managed fund.

Establishing a self-managed fund is relatively easy. If there is more than one person involved in the fund they must ordinarily have a familial or business relationship. The only obligations preventing a person from establishing a self-managed fund are that the trustees cannot be a “disqualified person” (person convicted of a dishonest offence, undischarged bankrupt, subject to civil penalty order or otherwise disqualified by a superannuation regulator) or a minor.

The current four major steps to setting up a new self-managed fund include:

- Obtain a trust deed

- Lodge an application for TFN/ABN registration with the ATO. This includes
 - election with the ATO to become a regulated fund
 - trustee's TFN details or their residential address
- Develop an investment strategy – required under the SIS Act
- Open a bank account – while not strictly required under law, is ordinarily done.

When lodging the election, the ATO does no substantive check of the suitability of the trustee beyond any self-declaration made by the applicant about their status as a disqualified person. We understand that the ATO now does a “post registration” check against various records to confirm that the trustee is not a disqualified person.

While the ATO does conduct reviews of self-managed funds and their advisers, the only regular external oversight required is by the external auditor, who must perform a compliance and financial audit on the self-managed fund. The external auditor is also required to notify the ATO of breaches. The requirements on the external auditor is that the person is a registered company auditor or a member of one of the accounting bodies – there is currently no requirement for the auditor to demonstrate any superannuation-specific training, knowledge or experience. As well, the external audit is performed after the end of the relevant financial year.

Most self –managed funds would have a bank account but it is not a legal requirement. Many self-managed funds rely on other professionals to provide advice or services – including solicitors, actuaries, financial planners or brokers. However, there is no statutory requirement to use these services (though an accountant is required to prepared the fund's accounts and, until recently, an actuary has been required to sign off on the paying of a pension from the fund).

The large number of difficult-to-supervise entities and the potential for collusion between the trustee and member (who are usually the same person) may represent a risk for money laundering and terrorist financing, but if that is the case, the provisions in the Bill for customer information and AML/CTF Programs just do not work for this group.