



Investment & Financial Services Association Ltd  
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26 February 2003

The Secretary  
Senate Select Committee on  
Superannuation and Financial Services  
Parliament House  
CANBERRA ACT 2600

Dear Ms Morton

**Reference:**

**Superannuation Industry (Supervision) Amendment Bill 2002  
Superannuation (Financial Assistance Funding) Levy Amendment Bill 2002**

The Investment and Financial Services Association is a national not-for-profit organisation, which represents the retail and wholesale funds management and life insurance industry. IFSA has over 100 members who are responsible for investing approximately \$620 billion on behalf of over 9 million Australians.

**Background**

Currently, the responsible Minister has power under Part 23 of the Superannuation Industry (Supervision) Act (SIS) to make compensation payments where individuals have suffered loss from their superannuation accounts as a result of theft or fraud. The current Minister has a policy of making payment at 90cents in the dollar.

The issue of compensation for loss was canvassed at some length during the recent review of 'safety' in superannuation. The result of that process was that the existing compensation provisions would remain.

These Bills would put in place arrangements for an annual levy on superannuation funds to recover compensation payments from superannuation funds. The levy would recover the full amount paid in the previous year, spread across superannuation funds. The levy would be subject to a minimum and maximum amount per fund for administrative simplicity and to avoid some large amounts being levied on larger superannuation funds.

We understand that Senators may wish to take the opportunity to consider some of the wider issues associated with the means of recovering payments made under Part 23.

## Who pays compensation?

IFSA expressed a view during the recent review that funding compensation from other superannuation funds was not necessarily desirable. The following is an extract from our Submission to the Superannuation Working Group review of superannuation safety.

### *Assistance to failed superannuation funds*

Both the Options and Issues Papers canvas remedies for losses arising from failed superannuation funds. SIS Part 23 provides for trustees to seek assistance for losses arising from theft or fraudulent conduct, but do not extend to misleading and deceptive conduct.

The circumstances of superannuation investors who have lost savings through collapses such as CNAL have been well documented by the Senate Select Committee on Superannuation and Financial Services, and make compelling reading. Whether or not these savings represent compulsory contributions, it is difficult not to contemplate changes that would allow compensation to reach these people.

It is very important to consider who would make this compensation. Currently, compensation could come from either consolidated revenue, or from a levy on superannuation funds. Compensation from consolidated revenue would represent a contribution from all Australians. On the other hand, levy-based compensation would fall unevenly, depending on which funds were levied and how the costs were passed on to fund members. For instance, people with multiple accounts could well pay more towards a levy than people with a single high balance account. Members of public sector (and unfunded) schemes might escape contribution altogether. These issues would not be overcome by simply earmarking a percentage of the existing levy revenue toward a fund.

Given the low incidence of scheme failure, and the equity problems associated with a levy, the creation of an assistance fund does not appear to be warranted. As with the various solicitors' fidelity funds, the creation of a fund can have its own problems. Chief among these is that compensation can depend upon the balance of the fund, the number of calls made on the fund in a given year, and the ability of a fund to raise additional levies in the event of significant calls.

Regardless of how compensation is funded, there is a problem that widespread compensation could create a moral hazard problem. Superannuation contributors might well be less likely to select a scheme carefully if there is ready access to compensation. As was noted at the roundtable, partial compensation could address this issue.

All these issues would be better addressed through effective prudential supervision in the first place, rather than *post facto* compensation. For instance, the reporting timeframes in current superannuation legislation are much less immediate than those under MIA provisions. In the case of CNAL,

and perhaps EPAS, many more players would have had personal obligations to report concerns to the regulator, and to do so immediately. If the regulator acted quickly on these reports (which SIS provides – eg replacing the trustee), this action may have reduced potential losses before they eventuated.

Taking these issues as a whole, IFSA does not believe that superannuation investors would be well served by implementing broad compensation arrangements funded from other Australians' retirement savings.

We have not changed this view, but do wish to press the issue under this reference. The Bills do not extend the reach of compensation beyond the current Part 23 provisions.

### **Annual levy**

IFSA sees difficulties with the full recovery of levies in the year following their payment.

The first problem is that levies will fluctuate. A smoothing arrangement would reduce fluctuations, and we would suggest that this could combine and average a number of years. This way, year on year variations would be minimised.

The second problem is that levies will be unpredictable. Superannuation funds will not be able to assess the level of the levy until the end of the relevant financial year. Consequently, trustees will be unable to estimate the level of levy to be recovered from members' accounts via fees. Nor will trustees be able to disclose those fees in advance. An arrangement to spread recovery over a number of years would give trustees knowledge of a reasonable proportion of the levy further in advance, allowing them to better estimate and disclose fees.

We suggest that these problems be resolved by spreading the recovery of compensation amounts from levies over a five-year period. An even spread of 20% per year will damp fluctuations quite significantly, and allow trustees to set fees with foreknowledge of greater than 60% of the final levy amount.

As the recovery system matures, the initial cost to government of this spread will disappear. Given that total compensation amounts are so far very small in Commonwealth fiscal terms and as a proportion of funds under management in superannuation, the fiscal cost of a spreading mechanism is easily affordable.

Yours sincerely

*(Bill Stanhope)*

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