

Senate Select Committee on Superannuation and Financial Services

Main Inquiry Reference (a) + (c)

Submission No. 87

(Supplementary to Submission No. 76)

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THE TREASURY

17 October, 2000

Senator John Watson
Chair
Senate Select Committee on Superannuation and Financial Services
Parliament House
Canberra ACT 2600

Dear Senator Watson

Main Inquiry – Matters pertaining to superannuation and financial services: references (a) and (c)

I refer to the Committee's request for officers of the Treasury to assist the Committee in its Main Inquiry at a hearing on 17 October 2000.

To further assist the Committee with its inquiry the Department of the Treasury has prepared comments addressing the issues brought to our attention by the Committee Secretary. It should be noted that the comments do not address issues regarding the administration of the Superannuation Guarantee legislation by the Australian Taxation Office.

I trust that this information is of assistance to you.

Yours sincerely

Roger Brake
General Manager
Retirement and Personal Income Division

TREASURY COMMENTS ON ISSUES RAISED IN EVIDENCE TO THE COMMITTEE INQUIRY.

Superannuation Guarantee

1. *Current Superannuation Guarantee arrangements*

Disability insurance

Superannuation funds may purchase disability insurance to pay temporary incapacity benefits to their members. The payment of temporary incapacity benefits is a recognised ancillary purpose under the Sole Purpose Test contained in Section 62 of the SIS Act.

The actual payment of temporary incapacity benefits to a member is subject to the payment standards in Part 6 of the SIS Regulations; In particular:

- benefits may only be paid in the form of an income stream during a period of incapacity from employment, and
- benefits cannot be a paid from member's minimum benefits (Award, SG and personal contributions and earnings). This condition prevents superannuation guarantee amounts from being eroded through the direct payment of temporary incapacity benefits from these amounts.

Insolvency arrangements

Under the Corporations Law, superannuation guarantee payments are awarded the same priority as employee wages in the winding up of a company. These amounts rank ahead of all other unsecured amounts due to employees.

2. *People over 65 years of age who continue to work;*

Age limits and work tests apply to ensure superannuation's role as providing for retirement and not for estate planning purposes.

Superannuation Guarantee contributions must be made if workers are less than 70 years old and award-related contributions must be made regardless of the employees age.

Other contributions can be made if a work test of 10 hours per week is satisfied up until the age 70.

The Australian Prudential Regulation Authority (APRA) state in Superannuation Circular No.I.A.1 *Contribution and Benefit Accrual Standards for Regulated Superannuation Funds, September 1998* that trustees must be satisfied that the member is gainfully employed for a minimum of 10 hours each week and that the trustee must have arrangements in place, such as monthly monitoring;

A superannuation fund must generally cash benefits for a member between 65 and 70 years of age, who is no longer employed for 10 hours per week, or a member over 70 years of age who is no longer employed for 30 hours per week. However, post – 65

Superannuation Guarantee and Award contributions must remain in the fund until these contributions cease being made or are no longer liable to be paid.

3. *International protocols for dealing with visiting overseas workers;*

In general, employers are required to make Superannuation Guarantee (SG) contributions on behalf of non-residents working in Australia.

The Government currently provides an exemption for certain non-resident senior executives who meet the eligibility criteria for the former Class 413 (Executive (Overseas)) visa, which in 1996 was incorporated into a new single Class 457 Business (Long Stay) visa. These individuals have been excluded from the requirement to have SG contributions made on their behalf because they are usually in Australia for only short periods and have retirement income arrangements in their home countries. They are typically brought to Australia because of their unique specialist skills and experience.

The Government has also provided an SG exemption to non-residents who have entered Australia and are employed between 1 January 2000 and 31 December 2000 solely and directly in connection with the Sydney 2000 Olympics or Paralympics.

The Government has also entered into bilateral negotiations with several countries to include provisions within social security agreements to exempt employers from making SG contributions on behalf of non-resident employees seconded to Australia where those employees are covered by an equivalent scheme in the other country.

To date, formal negotiations have commenced with Austria, Canada, Chile, Croatia, Finland, the Netherlands, Norway, Portugal, Spain, Switzerland, and the United States. While some of these negotiations are quite advanced, it is not possible to determine when the first successful agreements may be concluded.

Regulatory framework

4. *Financial Services Reform Bill*

On 11 February 2000, the Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, released the exposure draft *Financial Services Reform Bill* (FSR Bill) for 3 months' public comment.

The FSR Bill will put in place a regulatory framework for the financial services industry that facilitates innovation and promotes business, while at the same time ensuring adequate levels of consumer protection and market integrity. The proposed regulatory framework will cover a wide range of financial products including superannuation. The Australian Securities and Investments Commission (ASIC) will be responsible for its administration.

5. Regulatory Gaps and Overlaps

Some argue that there are overlaps between the proposed FSR licensing regime and APRA licensing. However, these two licensing regimes serve different purposes, and are a consequence of the implementation from 1 July 1998 of the recommendations of the Financial System Inquiry (Wallis inquiry) for a 'twin peaks' regulatory structure for Australia's financial system. In particular, APRA licensing does not address the market integrity and consumer protection issues that the ASIC-administered Australian Financial Services Licence (AFSL), under the FSR Bill, regime will deal with.

6. Financial Sector Levies

The Minister for Financial Services & Regulation announced the terms of reference into the review of financial sector levies on 3 August 1999. The review was undertaken by the Treasury and the Australian Prudential Regulation Authority.

The review was required to evaluate the current levy arrangements' ability to provide an effective funding mechanism for the supervision of prudentially regulated institutions, and to make recommendations on any changes required to ensure there is an efficient, equitable and durable funding mechanism capable of meeting needs well into the future.

The legislative framework for the current levy arrangements was passed by Parliament at the same time as the major package of legislation relating to the recommendations of the Financial System Inquiry on 1 July 1998. As the starting point for each sector was so different, it was not possible to move to a common architecture at that time without disruptively large changes. Therefore, the current legislation largely mirrors the levy framework that existed under the regime of the former Insurance and Superannuation Commission (ISC).

Consultation Process

The Treasury and APRA followed a process of close consultation with industry throughout the review to ensure that industry had significant opportunity for direct input into the review.

The review team sought submissions from relevant industry groups in August 1999, and the submissions were used to prepare a discussion paper which formed the basis for a round table discussion with industry on 15 December 1999. The discussion paper was circulated about two weeks prior to the meeting, and identified the key issues raised in the submissions and proposed three alternative levy models for consideration.

There were seven key issues identified in the discussion paper.

- Should the current sectoral approach continue or should an alternative approach be adopted, for example, by imposing the levy on a group basis?
- Should an attempt be made to avoid double counting of assets for the purposes of calculating the levy?
- Should the current system of minimums and maximums be continued, and if so, how should these caps be determined?
- Should the levy take account of the lower cost of supervising some entities within a sector (eg. foreign bank branches)?
- Should the levy be calculated and payable by all sectors at the same time?
- To what extent should fees and charges be imposed to recover costs associated with specific services undertaken by APRA?
- Should the levy on providers of retirement savings accounts be merged with the levy on ADIs?

Main Outcomes

Following the extensive consultation recommendations were made and accepted by Government on 28 April. The recommendations and the levy parameters for 2000-01 were then released to industry for their consideration on 3 May 2000, and Treasury contacted all industry participants to seek their comments on the report and the parameters on 15 May 2000. Following this last step in the consultation process, the Minister for Financial Services and Regulation announced the financial sector levy determinations on 9 June 2000.

The main recommendations of the review include:

- Continue to impose levies on a sectoral basis.
- Retain the concepts of minimum and maximum amounts payable.
- Charge small superannuation funds supervised by APRA the same rate as other prudentially regulated superannuation funds recognising the importance of these financial institutions receiving an appropriate level of prudential regulation. (Note that the levy rate for all superannuation funds was reduced by half in 2000-01 in recognition of excess levy collections in this sector in previous periods and the achievement of significant infrastructure savings.)
- That the 'double counting' of assets for the purposes of calculating the levy payable is not inconsistent with the goal of collecting revenue from the relevant financial sector to fund the costs of regulating that sector.

- The regulators are to provide more detailed specific activity cost information to assist with setting levies more reflective of the costs of supervision.
- APRA is to introduce fees and charges for non-supervisory elective services.
- Foreign bank branches are to be provided a concessional levy in recognition of the lower cost involved in supervising these entities.
- Undertake a review of the levies framework in around 2003 to consider the extent of convergence amongst sectors and whether a group based model would be more appropriate.

7. *APRA's enforcement powers*

The measures contained in *Financial Sector Legislation Amendment Bill (FSLAB) (No. 1) 2000* seek to address shortcomings in the SIS Act enforcement regime encountered by the Australian Prudential Regulation Authority (APRA) (and the former Insurance and Superannuation Commission) since that Act came into effect in 1994. We believe they will significantly strengthen the enforcement regime.

Issues Relating to the Superannuation Industry (Supervision) Act 1993

8. *Definition of 'dependant' for the distribution of superannuation benefits;*

A dependant is defined in the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) as including the spouse and any child (including any adopted child, step child or ex-nuptial child) of a person.

A spouse is defined in the SIS Act as including a person who, although not legally married to a person, lives with that person on a genuine domestic basis as their husband or wife.

The Australian Prudential Regulation Authority, in its Superannuation Circular No. I.C.2, *Payment Standards for Regulated Superannuation Funds, September 2000*, specifically notes that a dependant includes any person who was financially dependent on the member at the time of the member's death and that this may include a partner who does not meet the definition of a spouse.

Financial dependency is not defined in the SIS Act. Financial dependency can generally be established where a person relies or relied on another as the source, wholly or in part, of his or her means of subsistence.

Under the SIS Act, it is for the trustee to determine whether a person was dependent upon a deceased member, within the meaning of the legislation. Where the decision of the trustee is disputed, the Superannuation Complaints Tribunal is generally available to review the decision and resolve the dispute.

9. *The new provisions for binding death benefit nominations;*

The SIS Act was recently amended to enable superannuation funds to voluntarily structure their governing rules to accept binding death benefit nominations.

For funds that adopt this approach, the trustees would automatically pay the death benefit to the person named on the beneficiary nomination form.

The nominated beneficiary must still fall within the class of persons to whom death benefits can be paid under the sole purpose test in the SIS Act (ie, the member's legal representative or dependants).

To ensure that nominations are valid and kept up to date certain conditions for the acceptance of nominations are prescribed in the SIS regulations. These are that:

- the binding death benefit nomination will have a maximum operating life of three years; and
- a notice of a binding death nomination by a member must be in writing and signed and dated by the member in the presence of two witnesses.

10. *Regulation of funds with fewer than five members;*

The *Superannuation Legislation Amendment Act (No. 3) 1999* changed the definition of a self managed superannuation fund (previously known as an excluded superannuation fund) to require these funds to not only have fewer than five members but also to have all members as trustees of the fund.

The legislation also transferred the regulation of self managed superannuation funds to the Australian Taxation Office (ATO).

Funds with fewer than five members which do not meet the new definition continue to be subject to prudential regulation from the Australian Prudential Regulation Authority.

The measures form part of the Government's response to recommendations made by the Financial Systems Inquiry.

11. *Preservation rules – transfers to an overseas fund;*

The superannuation preservation rules are designed to ensure that superannuation savings that have benefited from Australian tax concessions are used to provide income in retirement.

Since 1 July 1998, permanent departure is no longer a condition for early release of benefits from superannuation funds. This change was intended to prevent non-residents from reducing their income tax liability by receiving (lower taxed) employer contributions in lieu of salary and wages and accessing those contributions on permanent departure.

The Government has announced that it would be prepared to enter into bilateral negotiations with other countries to facilitate the transfer of superannuation benefits by non-residents on permanent departure on a reciprocal basis (ie so that Australians residing and working temporarily overseas could also transfer their overseas pension entitlements to Australia).

Australia is yet to be approached by another country with a view to beginning negotiations on bilateral transfer arrangements. It is open to any country to approach the Government with a view to initiating bilateral negotiations on this issue. The Government's priority is to secure agreement on superannuation double coverage issues.

12. The impact of severe financial hardship claims on funds;

The Government's retirement income policy strikes a balance between ensuring superannuation is used for income in retirement while also ensuring that the restriction of superannuation benefits does not cause undue hardship.

The Superannuation Industry Supervision legislation therefore provides for the early release of superannuation benefits in a limited number of circumstances. The final decision on whether early release is permitted rests with the trustees of the applicant's superannuation fund, subject to the fund's governing rules.

Consumer protection

13. Financial Services Reform (FSR) Bill

The FSR Bill is designed to meet the need to ensure an adequate level of consumer protection is afforded to users of financial services. The FSR regime will streamline regulatory requirements so that there will be a single framework applying flexibly to a range of financial products and the financial services provided in relation to those products. It will also provide ASIC with harmonised powers and enforcement options for administering this single framework, to the benefit of consumers of those products.

14. Fee, charge and commission disclosure under the FSR regime

As part of the single licensing, conduct and disclosure regime, the FSR Bill includes a comprehensive regime for commission disclosure which targets the consumer's need for disclosure at various different points in the selling/advising process.

At the point of first contact with a client a financial service provider will be required to provide a 'Financial Services Guide' (FSG). The FSG provides clients with key information about the financial service provider and the type of service being offered, as well as details of the method and extent of charges for the service being provided – for example, whether an up front fee is charged, whether the financial service provider is being remunerated by commission, or is a salaried employee. Disclosure of charges at this stage informs the client about how they will be paying for the service.

Further disclosure will be required where a financial service provider provides personal advice to a client. The advice must include details of any benefit or advantage the financial service provider may receive in connection with the advice or the sale of a financial product, and of any other pecuniary or other benefits (including soft dollar arrangements) which may reasonably be expected to influence the financial service provider in giving the advice. Disclosure at this stage helps the consumer identify any potential influences on the advice given and to identify any potential conflicts of interest which the adviser may have in recommending a specific product.

Before a product is recommended or sold, whether advice is given or not, a client must also be given a product disclosure statement outlining the key information they need to know about the product. Included in the items that must be disclosed in this document are details of all fees and charges associated with the product and commissions and other similar payments that impact on the return on the product. The purpose of disclosure at this stage is to enable the client to assess the impact of fees, charges and commissions on the return on the product.

Under this layered approach to disclosure, consumers will receive an accurate picture of all fees, charges and commissions being paid and the impact of those fees, charges and commissions on the financial products they purchase. This should make it easier for consumers to 'shop around' among the different types of products available and chose the one that best meets their needs. Disclosure of commissions, fees and charges should also enhance competition between product and service providers.

The FSR Bill does not ban commission based selling for compulsory products as there is no disadvantage to the consumer in commission-based remuneration per se. Adequate disclosure of commission will allow consumers to assess whether the commission being charged is competitive and to make informed decisions about whether to accept the service/product to which the commission attaches.

A prohibition on commission could disadvantage some consumers. For example, low-income consumers, who might be in the most need of advice, may not be able to afford an up front fee for advice and in the absence of commission-based advice might forego valuable guidance.

15. Selection/appointment of consumer representatives to complaints bodies.

The Minister for Financial Services & Regulation, the Hon Joe Hockey MP carries Ministerial responsibility for consumer affairs. This includes accountability for the selection and appointment of consumer representatives.

To assist the Minister in this process, the Consumer Affairs Division of the Treasury maintains a register of possible consumer representatives.

Industry bodies sponsoring the placement of consumer representatives continue to play an active role in determining the selection criteria and conditions of appointment for individuals nominated by the Minister. This includes remuneration arrangements, where applicable.

Consumer representatives must also satisfy rigorous requirements in relation to their notification of actual or potential conflicts of interest. Further details relating to positions held by consumer representatives is located online at www.treasury.gov.au.

16. *Responsibility for education of consumers (for superannuation, banking and financial products).*

As the regulator of Australian Corporations Law, the Australian Securities and Investment Commission (ASIC) has regulatory responsibility for ensuring consumers are informed about the financial products they buy (at the time of sale and afterwards) and how companies distribute those products. They are also responsible for the consumer protection functions of the *Superannuation Industry (Supervision) Act 1993*, the *Retirement Savings Accounts Act 1997*, the *Life Insurance Act 1995*, and the *Insurance Act 1973* (The Australian Prudential Regulation Authority is the main administrator of these Acts).

ASIC have recently released a discussion paper on future consumer education initiatives. Entitled *Educating Financial Services Customers*, the paper includes:

- consumer information in identified priority areas of need (superannuation, financial advisers, margin lending and online brokers);
- education programmes to improve financial literacy within targeted consumer groups;
- examination of issues in banking affecting low income consumers;
- information on avoiding scams and fraud;
- promoting the role of ASIC to community intermediaries;
- development of greater partnerships and consultation in the development of education strategies; and
- ongoing media publicity of ASIC's activities.

17. *Profile of consumer affairs in government*

Consumer affairs is an integral component of the responsibilities of the Minister for Financial Services & Regulation and, as part of his charter, the Minister is responsible for market integrity and consumer protection regulation, including in relation to the financial system.

The Minister aims to promote self-regulation, develop national consumer protection laws and protect consumers using electronic commerce. Moreover, the Minister is responsible for:

- consumer protection in the financial system, in particular in relation to the deposit-taking activities of authorised deposit-taking institutions, insurance and superannuation;

- consumer education and product safety standards, including consultative arrangements with the States and industry bodies; and
- administrative matters concerning the Australian Securities and Investments Commission.

Consistent with his consumer affairs responsibilities, the Minister is actively involved in the selection and appointment of consumer representatives .

The Minister's accomplishments in the area of consumer affairs are as follows:

- In 1999, established an E-commerce Expert Group.
- In May 2000, released a best practice model for business - *Building Consumer Sovereignty in Electronic Commerce* (which followed the release of a discussion paper).
- Released a range of consumer information products (for example: *Keeping Baby Safe, A Country Focus, Attract More Customers*).
- Released and up-dated the *Directory of Consumer Dispute Resolution Schemes and Complaint Handling Organisations*.
- Established the Consumers Online Website - www.consumersonline.gov.au
- In 1999, established the Commonwealth Consumer Affairs Advisory Council.
- In 1999, released *Prescribed codes of conduct - policy guidelines on making industry codes of conduct enforceable under the Trade Practices Act 1974*.
- In 1999, established a Taskforce on Industry Self-regulation.
- Taskforce on Industry Self-regulation released an *Issues Paper* (October 1999) and *Draft Report* (June 2000).
- In May 2000, released a discussion paper titled *Product Safety Policy Review*.

And as noted, the Minister is responsible for the policy and administration of ASIC, APRA and ACCC.

Other issues

18. *Portability of superannuation benefits;*

The Government indicated its support for portability of superannuation benefits in its 1996 pre-election statement *Super for All - Security and Flexibility in Retirement*. The Government reaffirmed its support in its response to the Financial System Inquiry. Work is progressing on the full details of the Government's portability policy.

19 *Members of defined benefit funds that have reached their maximum contributions limit.*

Superannuation Guarantee contributions must be made to a complying superannuation fund. A complying superannuation fund can be either an accumulation fund or a defined benefit fund.

Where an employer makes contributions to a defined benefit scheme, they are required to obtain a benefit certificate from an actuary. The benefit certificate specifies the 'notional' rate of contributions required from the employer to meet the expected benefits of employees. This ensures that members of defined benefit funds receive the required level of employer support, based on the level of benefits they receive.

An employer will meet their superannuation guarantee obligations where an actuary has provided a benefit certificate stating that the employer is not required to make superannuation guarantee contributions.

Where an employer does not make sufficient superannuation contributions to satisfy their requirements under the *Superannuation Guarantee (Administration) Act 1992* they will incur the superannuation guarantee charge.