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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Structure and operation of the superannuation industry

MONDAY, 20 NOVEMBER 2006

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JOINT STATUTORY COMMITTEE ON

CORPORATIONS AND FINANCIAL SERVICES

Monday, 20 November 2006

Members: Senator Chapman *(Chair)*, Ms Burke *(Deputy Chair)*, Senators Brandis, Murray, Sherry and Wong and Mr Baker, Mr Bartlett, Mr Bowen and Mr McArthur

Members in attendance: Senators Brandis, Chapman, Murray and Sherry and Ms Burke

Terms of reference for the inquiry:

To inquire into and report on:

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.

WITNESSES

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RODGERS, Mr Malcolm, Acting Commissioner, and Executive Director, Regulation, Australian Securities and Investments Commission 57

SAVA, Mrs Helen Patricia, Company Secretary, Association of Independent Retirees Ltd 103

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Committee met at 9.06 am

CHAIRMAN (Senator Chapman)—I declare open this public hearing of the inquiry into superannuation. On 30 June 2006 the committee resolved to 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. The inquiry will examine a number of industry wide trends and sectoral issues and compare Australian and international experience.

May I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. This gives special rights and immunities to people who appear before committees. People must be able to give evidence without prejudice to themselves. Any act which disadvantages a witness as a result of evidence given to a committee may be treated by the parliament as a contempt. It is also a contempt to give false or misleading evidence to a committee.

If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. If the committee determines to insist on an answer, the witness may request that the answer be given in camera. Such a request may of course be made at any other time during the giving of evidence.

The parliament has resolved that an officer of a department of the Commonwealth shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. This resolution prohibits only questions asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted.

[9.08 am]

LEGG, Mr Chris, General Manager, Financial System Division, Treasury

LEJINS, Ms Erica, Senior Adviser, Superannuation and Retirement Savings Division, Treasury

LOVE, Mr David, Manager, Investor Protection Unit, Corporations and Financial Services Division, Treasury

MOORE, Mr Andre, Manager, Prudential Policy, Superannuation and Insurance Unit, Financial System Division, Treasury

CHAIRMAN—I welcome any observers to this public hearing and I now welcome our first witnesses, who are representatives of the Treasury. The committee has before it your submission, which we have numbered 55. Are there any changes or additions you wish to make to the written submission?

Mr Legg—No.

CHAIRMAN—If not, I invite you to give an opening statement, at the conclusion of which I am sure we will have some questions.

Mr Legg—I don't think we need to make an opening statement. I would just make the point that the issues raised in this cut across a range of areas in Treasury, so we have tried to ensure we have the right people here. I have to apologise: one of my colleagues, Mr David Love, is on his way. He works on the Corporations Act side of things, so if there are questions on issues there I believe he will be here in a few minutes. Other than that, we have my area, which is responsible for the prudential framework and the relationship with APRA, and we have a colleague from the revenue group, which deals with retirement income policy per se.

CHAIRMAN—Thank you. One of the issues the committee is examining is capital adequacy, capital requirements, and whether there should be uniform capital requirements across superannuation funds. In your submission you suggest that the government will revisit the capital requirements issue once the impact of trustee licensing and risk management reforms can be assessed. Can you indicate when this is likely to occur in the process?

Mr Legg—No, I am afraid I cannot. Beyond saying that there is not a precise timetable at the moment, the licensing regime has just basically taken effect in the sense that the process of licensing has concluded. This is just a personal view going forward, but I envisage we would need 18 months to two years experience before we were able to make any reasonable judgement about the experience of the new system. Once we are at that point, I would envisage—and here I may be speaking about future incumbents in my job—that there would be a reasonably full consultation process to ask those questions.

CHAIRMAN—In your submission you also refer to the December 2005 refinement to financial services regulation, including the introduction of a short-form product disclosure statement. To what degree has the industry adopted the short-form product disclosure statement and how has the short-form PDS assisted fund members to receive and understand relevant information?

Mr Legg—Here, Chairman, I am afraid we are hostage to the arrival of Mr Love, who is responsible for the ASIC part of this equation.

Senator SHERRY—In terms of capital adequacy and the role of a capital requirement, what do you consider to be the main issues in having a capital requirement for superannuation funds?

Mr Legg—The requirement for capital generally in a prudential system is to ensure that there are sufficient financial resources which are not claimed by others in a wind-up to be able to support the claims of your members should the institution get into difficulty. That remains the basic issue—whether or not the other aspects of the prudential regulatory framework are sufficient to give you comfort that, outside of the areas where you currently have minimum capital requirements, you do not need the capital. Obviously there are costs to holding capital, and the costs will ultimately be borne by members as well, so there is a trade-off there. I do not know if my colleague Mr Moore wants to say any more than that but they are the basic principles.

Senator SHERRY—In addressing that issue, you might address the prudent person test, the diversified structure of investments and the likelihood of a superannuation fund—I would contend extraordinarily unlikely—losing all its money, other than through theft and fraud, which I think is a distinct category. If you put aside theft and fraud, the likelihood of a mainstream superannuation fund, if I can call it that, under the prudent person test, excluding SMSFs, losing all or a large part of its capital is very unlikely.

Mr Moore—Assuming that the trustees meet the fit and proper tests and manage the fund appropriately, according to the prudent person test, and meet the requirements to diversify—giving mind to liquidity and so forth—I think that, yes, that would be a fair statement.

Senator SHERRY—It would be extraordinarily unlikely, wouldn’t it? We would be looking at the collapse of the entire economy, frankly, wouldn’t we?

Mr Moore—I think that there would be some broader issues to be worried about.

Senator SHERRY—They would be pretty cataclysmic events. In considering this issue, have you looked at the past record of mainstream super funds? Let us exclude SMSFs, which have a particular set of issues, and put aside theft and fraud, which, again, are very hard to legislate against—you can minimise them. Have you looked at the record of superannuation funds over the last 20 years since it has been compulsory?

Mr Moore—In terms of losses?

Senator SHERRY—Yes.

Mr Moore—Not specifically. There are some indications that losses are extremely low relative to the size of the overall industry. I am not sure what the exact figure is for claims under part 23 of the SI(S) Act, and we do not have the right people here to answer that, but I think it is around $60 million. Out of an industry approaching a trillion dollars it is a very small amount.

Mr Legg—The other consideration here is the nature of the financial promise that is being made. I am sure everyone understands that the financial promise being made in the case of superannuation is different from the sort of promise being made by an ADI or general insurer where you may have a different view about the need for capital, say.

Senator SHERRY—Yes, I accept that. Also, it is compulsory, which sets it apart from almost any other financial product. It is long term, it is complicated and there are reasons why you would have a more robust compliance/oversight/compensation regime. Part 23 is the theft and fraud provision, but if we put aside theft and fraud for the moment—I want to touch on that later—in terms of losses occurring outside the theft and fraud area, the track record of superannuation over the last 20 years is, frankly, pretty damn good compared with other financial investment vehicles.

Mr Moore—I do not know the exact numbers outside theft and fraud. APRA may have a better picture of that. I agree with your general statement that it is extremely low.

Senator SHERRY—Theft and fraud are compensatable for up to 90 per cent of losses. Is that correct?

Mr Moore—That is government policy.

Senator SHERRY—That is the act, isn’t it?

Mr Moore—No, the act does not specify an amount; it is at the minister’s discretion. The government’s policy is that it will pay up to 90 per cent.

Senator SHERRY—Why 90 per cent?

Mr Moore—I think the government’s view is that there is a moral hazard element that it wants to factor into what it is prepared to cover under the theft and fraud provisions. That recognises that it is the member’s own money and that the member is responsible for that money and where it is invested, and that that element should be recognised in the quantum of the payout. As such, they have limited it to 90 per cent.

Senator SHERRY—Where is the moral hazard when it is compulsory?

Mr Legg—There is a moral hazard in the choice of fund. The convention of 90 per cent reflects a judgement, but where you are talking about fraud issues per se there is a judgement being made that members should be able to assess the quality of the fund manager in terms of that particular type of risk and be prepared to wear some of the cost if they get that judgement wrong. You can disagree about whether that is possible or not but that is the judgement being made about the particular type of risks involved that are compensated under part 23 and the reasonable expectations of members.

Senator SHERRY—You mention moral hazard with respect to choice of fund but the policy was up to 90 per cent compensation before we had choice of fund, and that has not changed.

Mr Legg—Members still can apply some discipline to the way in which funds are managed and in which trustees operate. That is the basic philosophy behind the 90 per cent. Moral hazard issues are always very hard to wrestle with, and you can argue these things a variety of ways. But I think that is the rationale behind the government's policy.

Senator SHERRY—I do not agree with the conclusion, although I understand the debate and the rationale. There are many individuals in our compulsory system who do not have choice of fund. It is not an absolute choice of fund regime we have at the moment. Would you accept that? There are circumstances where choice of fund is overridden.

Mr Legg—I will look to my colleagues in retirement income policy to advise me on this.

Senator SHERRY—Before you respond, the majority of members actually default on fund membership. Whether that is a good or bad thing, that is the fact of life. They default on their fund—they go to the fund that is the default nominee. Secondly, choice of fund is overridden in quite a number of circumstances, such as in defined benefit schemes and in industrial provisions. There are some industrial provisions—AWAs and certified agreements—which override choice of fund. So do you think the validity of the argument of 90 per cent compensation on moral hazard would apply in those circumstances?

Ms Lejins—It is perhaps more appropriate if you ask Mr Legg that question.

Mr Legg—If the question is, 'Do you think the policy is right?' I do not think we can answer that.

Senator SHERRY—I did not ask that question.

Mr Legg—You are really, because you are saying, 'Would the validity of the things to apply—

Senator SHERRY—No, you are not required to do that: your requirement is to answer my questions.

Mr Legg—I think you can still make the case, and clearly that is the government's policy. I am not really able to put a view here, whatever my personal view would be, which would question the validity of the government's policy.

Senator SHERRY—Okay. Let us go back to capital adequacy. We have compensation up to 90 per cent in the event of theft and fraud. Let us put that category aside for the moment, because we know under part 23 it is about $60 million, and I think that is about the right figure. We have a very good track record in terms of superannuation investment in this country: prudent person, diversification, trustee governance seem to be very robust. Have you looked at this issue in the context of other countries?

Mr Moore—No, we have not done any specific research on how we track in terms of losses relative to other countries.

Senator SHERRY—Particularly in terms of private sector comparisons. Could I suggest you should in the context of examining this issue. Why would you change the capital adequacy rule, given the robust nature of our system to date prior to the current licensing regime, which presumably has made it more vigorous in terms of oversight?

Mr Legg—You may well be right. It may well be that you reach a conclusion that there is no case. Nonetheless, the government has said that it will come back to this issue to ask the question. I think it is entirely appropriate once you put in place a new system. I agree with you: it is in many ways a more robust system, but it is nonetheless very different. You have a much smaller group of trustees. It is entirely reasonable to ask the question at some point and you ask the question in a vigorous and open-minded way. I think the view you are putting is a very honourable one and there will be others who will put the view at the time, but you still need to ask the question.

Senator SHERRY—Sure, I accept that, but there is an issue of certainty here.

Mr Legg—Yes.

Senator SHERRY—What comes through from the industry, and to a significant extent members of superannuation funds, is certainty in the rules going forward. There has been massive change in the whole gamut of superannuation over the last 20 years. Certainty going forward is an important issue now—more important, I would suggest. Would you accept that people want to know what the rules are?

Mr Legg—I accept that all the time in any financial system area and any area of regulation. I think that is a basic starting point.

Senator SHERRY—And you would accept that there have been constant changes to superannuation supervision regulation—a whole raft of changes—every year for the last 20 years?

Mr Legg—I accept it is an area where there has been regular—

Senator SHERRY—Significant and constant change.

Mr Legg—Significant change.

Senator SHERRY—I have one final point on this issue. Could you take it on notice—it is perhaps something that APRA should do as well—to from your perspective identify cases over the last 20 years in respect of compensation theft and fraud under part 23 and other examples, if you can find them—and I would be interested if you could find them—where you believe there has been a serious breach leading to investment losses of the prudent person principle by trustees? So there are two categories of response: part 23 and significant losses outside the SMSF sector, which I think is a different category. I will conclude my questions on the SMSF sector.

Senator MURRAY—I just wanted to ask a question relevant to that risk area you were covering.

Senator SHERRY—I will just conclude on this SMSF question. SMSF—no wonder they call it DIY; it's easier to say!

Mr Legg—Some people call it 'smurfs', which always makes me think of little blue characters.

Senator SHERRY—Yes. I do not like the term DIY, though. Have you examined the investment profile in the SMSF sector, or do you have information on the investment profile of that sector?

Ms Lejins—I understand that the ATO does have some information.

Senator SHERRY—Have you been examining regulatory issues with respect to this sector? There have been some announcements in the latest budget package finalised about issues around the SMSF sector, and the regulatory fee was increased—tripled, I think. What are the concerns and the issues that have led to the increase of that regulatory fee that I referred to?

Ms Lejins—As part of the government's plan to simplify and streamline superannuation, a number of changes are being made to the regulation of self-managed funds. The number of self-managed funds has been increasing significantly over the past decade and the government has stated that it is concerned about the general level of compliance with superannuation law by self-managed superannuation funds and also generally about the low levels of trustee knowledge of their responsibilities. Given the scale of tax concessions given to superannuation, it is important that the self-managed superannuation industry be properly regulated.

Senator SHERRY—Yes, I understand all that.

Ms Lejins—Also, I think in the context of the plan to simplify superannuation the restrictions on making contributions to superannuation will be critical to avoid abuse of the taxation concessions. Therefore, in order to address those concerns, there are a number of changes being introduced aimed at improving self-managed superannuation fund compliance.

Senator SHERRY—Such as?

Ms Lejins—Such as the one that you have mentioned—increased funding to the ATO.

Senator SHERRY—The money has to be for something, so what are the concerns the department has that it identifies around the issues of self-managed super funds?

Ms Lejins—The government has stated that it is concerned about the overall level of compliance by self-managed funds with the law and the extent of trustee education and the understanding by trustees of their responsibilities.

Senator SHERRY—So has the department done any work on examining the education or knowledge of these trustees?

Ms Lejins—You would need to ask the ATO. It is their responsibility to administer the law in this respect.

Senator SHERRY—I understand that, but you are part of Treasury and you have issued or had an input into a document. I would expect you to have knowledge of what the weaknesses are.

Ms Lejins—I think there is general acknowledgement from the government that the level of trustee education and understanding of their responsibilities is not adequate.

Senator SHERRY—Let me put it this way: I do not want to go to government policy—that is an area I cannot go to. What has the department examined in the context of self-managed super funds? Has it done any work in this area?

Ms Lejins—The department has a role to advise government.

Senator SHERRY—Sure. So what issues have you been examining around self-managed super funds?

Ms Lejins—The Treasury has certainly looked at data that the ATO has provided on the level of compliance by self-managed superannuation funds. We are certainly aware of the significant growth in the industry over the past decade. We have looked at a benchmarking study undertaken by the ATO, which found that fewer than 45 per cent of funds were fully compliant and that nine per cent had serious compliance issues. That study also showed significant evidence that only 70 per cent of self-managed funds lodged their tax and regulatory returns on time. So the government has certainly looked at the information that the ATO has provided in response to its administration.

Senator SHERRY—Frankly, you are telling me something I know already. I am interested in what Treasury are doing in this area other than just collating reports and looking at reports of the ATO. Have you done any specific work yourselves?

Ms Lejins—We have an ongoing role to advise government.

Senator SHERRY—I understand you have an ongoing role to advise government, but I want to know whether you are doing any work yourselves. Is it just a coordinating role, or are you doing anything actively as a department?

Ms Lejins—We do not actively administer the legislation. We obviously have a role to advise government on issues as they come to hand.

Senator SHERRY—What are the issues you as a department, or as a section of the department, are examining? Or are you doing nothing other than coordinating materials from the ATO?

Ms Lejins—As I have stated, we have looked at compliance issues that have fed through from the ATO's benchmarking study. Similarly, we have looked at issues of trustee awareness of their roles and responsibilities.

Senator SHERRY—How have you looked at those? Have you looked at some surveys? Have you done any surveys?

Ms Lejins—We have looked at information that has been provided to us from the Australian Taxation Office.

Senator SHERRY—Have you examined the issue of part 23 applying to self-managed superannuation funds—that is, compensation in the event of theft and fraud?

Ms Lejins—Part 23 currently does not apply to self-managed superannuation funds.

Senator SHERRY—I know that, but have you examined the issue?

Ms Lejins—No.

Mr Legg—I think that issue was last addressed in the review of part 23. Conclusions were made on that point, so we have not revisited it since then.

CHAIRMAN—I have a couple of questions in relation to member investment choice. In the submissions we have received and also in public evidence so far there has been some criticism of APRA's superannuation circular on member investment choice. Are you aware of those concerns? What is your analysis of those concerns?

Mr Legg—I was aware of understandable industry interest when the circular was being prepared. There was quite a bit of consultation at that time. I have been struck by the fact that there have not been major concerns raised with us since the circular was put out. My sense—and I appreciate that various parts of the industry may still want to repeat concerns they had then—is that they have all been taking the view of, 'Let's see how this works, work through it and see if there are major problems in practice.' The fact that they have not come back since and raised issues in terms of the practical consequences of how they get balance right has given me some comfort. But I understand the basic issue, which is the tension between choice on one hand and the need to meet your obligations as a trustee under the SI(S) Act to look after the viability of the entity as a whole on the other. Therefore, choice is probably constrained to some extent in terms of the range of investment options you can offer to your members. We are very comfortable with the position that was finalised in the circular, so, in terms of the policy status, we are very comfortable with that outcome and the way APRA is interpreting it.

CHAIRMAN—On page 14 of your submission, in the paragraph relating to the relationship between trustees and financial planners, you say that 'the extent to which a trustee can consider financial planner advice will always be incidental' to a trustee formulating and implementing investment strategy. Can you elaborate on that?

Mr Legg—Mr Moore is much more technically expert on this than I; however, I think the point we are making is that, first and foremost, the trustee has to meet his or her requirements and obligations under the SI(S) Act. Those requirements involve ensuring that the choices that are offered produce an overall diversified and sustainable outcome for the fund as a whole. We are making the point that the trustee cannot abrogate that responsibility to a financial planner on the basis that the financial planner knows the customer better, because the SI(S) Act requires

them to know the fund and the entity. It does not mean that the financial planner cannot be a very helpful source of advice to the individual member in choosing between funds and the like, but the trustee has an obligation that comes before that.

CHAIRMAN—Do you have something to add to that, Mr Moore?

Mr Moore—No, I think Mr Legg has summed it up pretty well.

CHAIRMAN—At the end of the day, does the trustee have the capacity to override the decisions of a member based on a financial planner's advice?

Mr Legg—It is not a matter of overriding. The trustee offers choices consistent with their obligations under the SI(S) Act, and the member makes the choice within that suite of options. If the suite of options appropriate for that fund and that entity in terms of the trustee's obligations does not meet the requirements of the fund member, they can go to another fund, or perhaps the demographics will allow for a different choice range to be offered to them. They are taking advice from their planner, but the trustee cannot take advice from their planner.

CHAIRMAN—So, in that context, it would be a matter of the member changing funds to get the investment profile that the planner is recommending.

Mr Legg—If they accept the advice that it is right for them.

Ms BURKE—Is there a role for individuals to get personal advice?

Mr Legg—When you are dealing with personal financial issues, it is always advisable to take advice from sources that you believe have credibility and legitimacy and that you have some trust in. I would never say that people should not take personal advice, although some people may feel quite comfortable making these judgements on their own.

Ms BURKE—If you are going to be limited to what you can use that advice for—and you have just said that it goes back to the trustees in a suite of advice—why pay a planner to give you a rundown on where to put money when you cannot do that anyway? Isn't that part of the conflict between getting personal advice on where to put money and how to use it versus what the trustees are required to do?

Mr Legg—The trustees have to have an eye to their overall membership. The demographics of the membership of one fund may differ from another. There are a range of choices and they differ. I see the point that you are making but I am not certain that it is an inherent tension. The advice to someone may be that, while they cannot get what they need from this fund because of other people who are part of it and the basic structure and risk structure of that fund, they would be better off going to someone else because it suits their circumstances better. That seems entirely reasonable and it still ensures that the trustee is meeting their obligations to the fund as a whole.

CHAIRMAN—Mr Love, before your arrival we asked some questions that were relevant to you, which we will now go back to. In relation to the role of advice, the Treasury submission points to the December 2005 refinements to financial services regulation, including the

introduction of a short-form product disclosure statement. To what degree has the industry adopted the short-form product disclosure statement and how have short-form PDSs assisted fund members to receive and understand relevant information?

Mr Love—From the discussions I have had with industry so far, I understand that there has been a relatively slow take-up of the short-form prospectus provisions. However, that is also connected with refinements that are coming up in relation to allowing for incorporation by reference of information within prospectuses. Industry has indicated that it also needs incorporation by reference to make the short-form prospectus measures work more effectively.

Senator SHERRY—What do you mean by ‘relatively low take-up’? Have you done a survey?

Mr Love—At this stage it is based on discussions with the industry participants. We have not done a survey of the number of PDSs that are actually being put into short form at the moment. I know, from discussions with some of the major product providers in relation to both superannuation and managed funds, that they have been looking at producing short-form prospectuses, but at the moment I think there are relatively few on the market in terms of the overall number of PDSs.

Senator SHERRY—I would agree with that. I am just interested in what you view as a relatively small number. Are we talking about less than 10 per cent, a small minority?

Mr Love—At this stage, based on what I would call anecdotal information from discussing it with industry players, yes, it would be less than 10 per cent take-up.

Senator SHERRY—When you refer to a short-form PDS, what length of document are you talking about?

Mr Love—What we have allowed to happen is that you basically could encapsulate most of the information, we feel, within about 10 pages with a short-form document. What has also been included in the discussions with the industry is whether or not it would be desirable also to allow some incorporation by reference of material which is further changes that we are putting in place at the moment.

Senator SHERRY—And isn’t there also a significant variation in layout in the hoped-for short-form PDSs? We do not have a standard in the sense that things are laid out in a consistent format.

Mr Love—One of the key areas that has to be maintained within a short-form PDS is all the information on the fee disclosure, which actually is a mandated format of information. That is actually one of the components still mandated in every PDS. So our feeling is that one of the key components of a short-form PDS actually is in a standardised form.

Senator SHERRY—When you say ‘standardised form’, it is not just the fees but other information as well?

Mr Love—No. We have continued to believe that the other information needs to be tailored to individual circumstances. That is why we have not gone down the path of mandating it, because we are really trying to cover a very broad range of products, even with superannuation products.

Senator SHERRY—I am just talking here about superannuation. There is a range of issues with other—

Mr Love—But even within superannuation products and how they present their investment strategies there is a considerable range of variation. The type of information that they have got to present now within a short-form PDS includes the key information about what the nature of the fund is and its key investment strategies, which is all allowed to be in a summarised form. So there is a general level of guidance about how things are to be presented, we feel, within the current rules.

Ms BURKE—Do you think the fairly financially literate community we have got out there can compare? That is why they are getting these things, so that they can actually compare this information versus that. If they are not standardised, how can you sit down and make a comparison and decide which is the best for you?

Mr Love—One of the key areas has always been the fee side. That is where we made a move to standardised information. With regard to other aspects of how they go about their strategies, that is much more the sort of soft information about how you present your PDS. The industry has been going through a learning curve ever since we introduced all the financial services reforms a few years ago. There clearly has been a learning curve on how PDSs are being presented.

There is still talk of the archetypal PDS of 80 or 100 pages but, in reality, when you see most of the products out there in the marketplace you note they are considerably shorter than that. In fact, when we looked at the nature and the content of the information in it, we found a number of the retail funds were presenting their investment options, something that is not mandated in the law as such. That was information regarding all the different strategies, an area that more than anything else seemed to be driving up the length of documents.

Senator SHERRY—Has there been any consumer testing of layout to determine readability and understandability?

Mr Love—That matter is the responsibility of the industry, because the onus is placed on the industry to produce documents.

Senator SHERRY—Why? Government does determine the parameters for the issuing of these things. As you do consumer testing, propaganda advertising and everything else under the sun, why hasn't there been consumer testing of the readability of these documents? You are issuing guidance and advice to industry. It seems to me pretty fundamental, yet this is just not being done.

Mr Love—It is an element that has got to be done by the industry. That is the view from our side.

Senator SHERRY—My question to you is: why haven't you—the department—done it?

Mr Love—Because all you would be doing is looking up one particular format—that is, the type of testing you would get done—or you would give a couple of variations. Say you produced results on one or two formats. As soon as you put them out and said, 'This is a standardised format,' the type of feedback that you would be getting—and it is the sort of feedback that ASIC has got when it has tried to put out guidance on fairly standardised documents—would be: 'Well, that doesn't fit these circumstances and that does not fit those circumstances, so that is not really helpful to the industry.' After all, their job is to try to communicate with consumers. It is in their interests to produce a document that is readable and friendly.

Senator SHERRY—But they are not. They complain to me all the time that they are not able to do that within the parameters and guidelines that are laid down by ASIC and by the department as you advise them.

Mr Love—That is why we have worked hard to try to give them much flexibility while still maintaining that there is essential information that has to be presented. It is trying to allow the industry—they know the consumers; they know who is coming to them and they know the type of feedback they are getting directly from the marketplace—to produce readable documents in a way that suits the marketplace.

Senator SHERRY—Has the department done any research into what extent consumers read these documents and understand them? Has it compared them?

Mr Love—Not consumer surveys as such.

Senator SHERRY—Again I ask: why not? For a capitalistic system you argue the theory of choice in an economic context and you argue the theory of competition. That is based on people's knowledge of a product and on giving them knowledge that is understandable, so you can get effective competition. So why don't you do it?

Mr Love—As I said, the point about us doing research is this: the type of feedback that we would get would not give us very useful information.

Senator SHERRY—But you do not know because you have not asked.

Mr Love—We do a lot of talking to the industry players who actually have to produce these documents and to ASIC, who are much closer to the coalface and are talking to consumers and are carrying out work with consumers. As I said before, the emphasis has been on giving the industry players, those on the ground who produce documents so they can talk to consumers directly, the latitude to be able to market-test their documents, to get something that is consumer friendly and meets the requirements of the law.

Senator SHERRY—If you are not doing it—I think you should, but you are not—what information have you received from industry about the extent to which these documents are read and understood?

Mr Love—The documents are for the mid-range of the consumer place. They are really used as part of the whole of giving advice. Often they are not documents that are read in isolation by a consumer. There is a range of consumers out there. I could read a PDS and probably understand

it without any intermediation. A lot of the documents have been used as part of the advice process. The advisers are using them to point out matters in relation to a product and are using them as an advisory tool when they are giving advice on superannuation.

Senator SHERRY—I understand all that waffle, which is what it was. Just tell me, please, what response in terms of surveys the industry has given you about the readability of these documents. Surely, if you have not done surveys, the industry has. Do you know of any player in the industry, a financial provider, a peak organisation, that has done a survey of the readability of these documents?

Mr Love—There is work done on a regular basis by IFSA with its membership, who look through the nature and the extent of the quality of the PDSs that are being put out. That is internal work.

Senator SHERRY—What are the results?

Mr Love—There continues to be room for improvement.

Senator SHERRY—That is not a result. Could 50 per cent, 60 per cent or 20 per cent of people read and understand them?

Mr Love—Certainly people can understand some parts of them. I think what has been said is that the presentation of the information that we did would enhance fee disclosure.

Senator SHERRY—This is all waffle, frankly. I am very disappointed in your response. Go back and take on notice, please, what the results are of consumer testing—the percentage of people who can read and who cannot read these documents. Here we are, four or five years on, and we still have not got this issue sorted out. So please go and get what hard data you can find on readability of these documents and give it to us on notice. I am surprised the department in the context of this ongoing difficulty with this stuff has not done any work itself. The industry is not exactly independent and without vested interest in regard to this issue, either, are they?

Mr Love—No.

CHAIRMAN—Following on from my earlier question about the PDS and the December 2005 refinements, I understand that parliamentary secretary Mr Pearce announced a further round of financial service refinements last week.

Mr Love—Yes. It was part of a wider set of proposals in relation to the corporate and financial services review that he has been carrying out. There are elements there that include changes to the financial services provisions.

CHAIRMAN—I understood that the whole CLERP and FSR process was to simplify this whole area of law, but it seems that it is now acknowledged that, rather than simplifying it, it has made it more complex and we now need to start simplifying it. How has this come about? Has it come about because you have ignored some of the recommendations this committee has made when it has looked at this legislation?

Mr Love—All that financial services reform process was a great sea change of changes. It was very difficult beforehand to modify, model and predict what kind of behavioural changes you would see coming out of it. That was a great difficulty for the designers of those particular reforms.

CHAIRMAN—I think this committee foresaw some of them when we made our recommendations.

Mr Love—A lot of those have been picked up in one way or another in slightly modified forms over time. We have carefully looked at what has happened on the ground, tried to understand exactly what has happened and then made adjustments to the system. It has been very important to maintain the integrity of the whole framework of the system, and there is no sense at all that we have really moved away from any of that. But it was really to look at a lot of details of, with things like the PDSs, how advice was being given on the ground and what was really happening in the real world and then to make adjustments along the way, basically allowing the marketplace to feed back to us.

CHAIRMAN—Am I correct in understanding that superannuation has been excluded from this recent announcement of the refinements—superannuation is not being included?

Mr Love—There is one particular proposal to introduce a threshold regarding advice. The threshold is set at $10,000. If you have an amount above $10,000 then the full statement of advice needs to be given. Below that threshold, in order to make things a bit more affordable and accessible for consumers, we are looking at an idea of the adviser being required to keep a record of advice in relation to that. At the moment the proposal has been put out excluding superannuation in relation to that particular proposal but not generally.

Senator SHERRY—That begs the question: are there any proposals in the pipeline for a discussion paper on superannuation specifically, other than this $10,000 issue which is referred to in the document?

Mr Love—Part of the other proposals that went out last Thursday is a model looking at how advice is given around sales recommendations which does include superannuation. Superannuation is part of the overall advice model there; it has not been excluded. In direct answer to your question, no, the idea behind the FSR advice regime was that it was basically supposed to not distinguish too much between various forms of financial advice so we are not creating a particular stream for superannuation.

CHAIRMAN—Some of the submissions that we have received highlight difficulties in providing educational information to fund members and discussing the internal features of a fund arguing that in some circumstances general information is not being provided because of fears of it falling under the personal financial advice regulations. Are you aware of that? If so, what is your response to those concerns?

Mr Love—Yes, we are very much aware of that and that is why one of the proposals put out deals with the issues around giving personal advice and general advice. One of the proposals that we have put out is that where there is no product sales recommendation or no remuneration specifically then that is exempted from the statement of advice in the detailed disclosure regime.

That is intended to allow people to talk in more general terms about superannuation and its benefits and understand the details about a particular individual without having to go and prepare a statement of advice.

CHAIRMAN—I understand that the Corporate and Financial Services Regulation Review has been looking at the issue of the appropriate boundaries between general and personal advice. What views were expressed by industry in this regard? What are your initial thoughts on refining that definition?

Mr Love—This is an area that is being dealt with within the proposals and, as a result of listening to both industry and consumers about what they wanted in relation to the giving of advice, a proposal has been developed around giving advice where there is a pure sales recommendation even though there is some personal advice. It would basically fit the old general advice model. So the idea would be that if someone was giving pure sales advice there, even though they have some of your personal information, the statement of advice does not need to be prepared. That proposal has come out of those discussions with industry.

CHAIRMAN—With regard to the statement of advice, the Association of Superannuation Funds of Australia has proposed that its requirements be refined to enable limited advice provision on investment and insurance choice options within a fund. Have you considered that proposal? If so, what is your view on it?

Mr Love—Again within the recommendation regarding making a pure sales recommendation, there is scope for considering that particular idea. That is a matter that I think we are going to get wider views on. We have certainly noted those views from one group. There is scope within the current proposal to look at that idea.

CHAIRMAN—With regard to managing conflicts of interest, I cannot recall which submission it was but one of the submissions we have received suggested that those involved in the financial services industry be separated into a group that might be called franchisees, who advise on only one group of products or one provider's products—that is yours—and then you have a group who would be defined as agents who advise on a multiplicity of products but still on a commission basis. Those two groups are remunerated on a commission basis. Then there would be a third group who are purely fee-for-service advisers who would be the funds' independent advisers. What is your view of trying to categorise advice into those three groups?

Mr Love—We have certainly examined those particular ideas. A lot of that thinking came out of what they tried in the FSA regarding the United Kingdom legislation. They basically polarised it into two extremes: you had the pure product sales advice where you could only deal with your own product provider's product line, so you were really like a salesman, and then you had the people who were completely independent and offered a whole range of things.

They found it extraordinarily difficult to make that work in the UK and they have had to move back from it into a situation that is much closer to the idea of authorising product lines that occurs here. We had a careful look at those submissions and suggestions to us—particularly on what happened in the UK and the difficulties they faced. As a result, the government has come forth with the proposal in regard to sales recommendations, which is aimed at making much more transparent and distinguishing more clearly for consumers the relationship between a

provider of a product and those who are giving, let us say, more disinterested client focused advice. This is the real tension with the conflicts of interest and commissions issue. We have an advice model now that was predicated on the assumption that everyone would be a completely disinterested adviser who would have only their client's interests at heart. That is the way things would work in an ideal world. However, the way products are distributed in the real world does not quite fit in with that, so we are looking at adapting the structure of financial services advice, increasing levels of flexibility and allowing for product providers who are integrated through their representatives to give what is called sales recommendation advice, with warnings around that.

This has a number of aims. We are trying to fairly and squarely deal with the issue of conflicts and we want to make as transparent as possible for consumers the relationship between the seller, or the person holding themselves out to give advice, and the product provider. We feel that this is the real difficulty. For example, if you are buying a car and you walk into a Holden dealer, you know that there is a clear relationship there and you assume that there are commissions being paid, even if you do not know the details. That relationship is very transparent and consumers understand it quite intuitively. At the moment, the way the personal advice model is set up, in many cases it appears to the consumer that they have an adviser who has only their interests at heart. We are saying that we think it is desirable to have a much clearer delineation between those two situations and, where an adviser is giving advice to a consumer and saying, 'This is in your interest. This is personal advice given to you,' it is absolutely essential that there be very strict adherence to an effective conflict management approach whereby you have to move away from having any conflicts as far as is possible. It is highly desirable to also move away from any sort of sales commission type remuneration for a fee for service. But at the same we are allowing for the possibility that you could have a sales recommendation channel on the other side where you approach the adviser and they give you advice but it is on the understanding that it is a sales situation.

Senator SHERRY—In considering distribution via a commission, how do you distinguish with the commission at the moment between the price of advice and the price of selling and distributing the product? It does not seem to me that that is clearly distinguishable at the present time when it comes to a commission. It seems to me that even if you could, it would be quite difficult to do it.

Mr Love—It is difficult. The government's position, which has been stated by the parliamentary secretary, is that there should be a clear connection between saying that if you have commissions, there should be a connection between the value of the advice given and how much you are paying for it through the commission. The real difficulty comes when you have things like trailing commissions, where there does not seem to be any connection between the value of the advice provided and how much the adviser is being remunerated. That is an issue that the government—as well as this committee and many others in the community—have identified as a significant problem for consumers in the marketplace. The government have said that the industry has to examine this and has to look at how it is going to deal with this particular situation. Within that context, that is why the sales recommendations idea has been developed—it is in order to try to make what is really happening much more transparent to consumers.

Senator SHERRY—Have you in reality, in terms of trail commissions, looked at the cost of advice as distinct from the money being paid to the individual for selling and distributing the product?

Mr Love—A breakdown between the salaries of a trailing commission over—

Senator SHERRY—Yes.

Mr Love—Not specifically. The figure that we have on the average advice model is that it costs about $800, when you are sitting down with a client, to give a full range of proper financial advice. So, commissions that look like they are around that sort of value point would seem to make sense within the marketplace. What goes on afterwards in regard to advice—

Senator SHERRY—Have you actually done some work on identifying figures on, for example, a statement of advice?

Mr Love—This is from discussions with industry players and representatives: the Australian Financial Planning Association and other places.

Senator SHERRY—It is not easy to get this information from industry, I have to say.

Mr Love—No, and we find it as difficult as anyone else to get accurate information. Even when you point out that you are trying to carry out survey work and all the rest of it, it is very hard to get anyone who is in a position to give you the sort of hard data that you want. We are constantly chasing after and trying to identify hard data. A lot of it comes back down to us looking at what has been happening—from the bits and pieces of information that you get in—and trying to put together a sort of picture of where things are at. As I said, something around $800 is the sort of estimate that Treasury has made about how much it costs to provide that sort of advice.

Senator SHERRY—That is good. I am glad to hear that. Have you looked at estimates of figures for what is called 'limited advice' within a fund—for example, level of death and disability insurance and what costs would be associated with that, or level of contribution? Have you looked at those sorts of issues?

Mr Love—Not specifically, as far as getting numbers out of the system and saying: 'That will cost X dollars or $100 or something to do that.'

Senator SHERRY—How do you examine the issue of authorised product lists in this context of competition?

Mr Love—We understand what is happening in the marketplace but—

Senator SHERRY—The reason I raise this issue is that an adviser cannot advise outside their product list. It seems to me that this is a chicken and egg issue. It is possibly anticompetitive in one sense, but the argument is that we need these because we need to get information and do research and all the rest of it. Is that a real argument in today's world where we only have, in the context of superannuation, some 300 licensed providers?

Mr Love—The authorised product list is driven by the structure of the legal obligations that flow on to the licensee about giving advice. On one hand, we have said that the licensee has to be responsible for the advice given and has to be confident in the products that are being recommended. So there is certainly a very strong and valid argument on the side of industry advisers saying, ‘We need to be sure about the products that we are making recommendations for.’

Senator SHERRY—Before we go on, let us look at the context of mainstream superannuation. We have a new licensing regime. These 300-odd entities are now all licensed. Why is that a problem? Why should that be a problem in terms of product lists?

Mr Love—They are licensed and they are prudentially regulated so in that sense the government would have confidence in the ability of those institutions to offer those products. However, that does not then mean that a private industry player looking at whether or not it is happy with the features and the nature of the products would suit the type of advice that it is giving against other products. That is a legitimate argument.

Senator SHERRY—But why shouldn’t a planner be able to make a recommendation on any licensed superannuation entity? They can get the information—but put that issue aside; I think that is now largely resolved. Why shouldn’t a licensed planner be able to make a recommendation in terms of limited advice within a fund?

Mr Love—From the government’s point of view there is no reason, and there is no reason from a regulatory point of view why they should not be able to. There is nothing in the law that actually stops them doing that.

Senator SHERRY—Except that it may not be on the product list, and that then becomes an impediment for the planner.

Mr Love—That has grown out of industry practice.

Senator SHERRY—I understand that. I understand the history of product lists and commissions. I know where all that has come from. It is about where we go forward.

Mr Love—It is an issue that has been monitored, as with other things in the financial services industry. It is growing and responding to the way the marketplace is regulated in this area. What I am saying is that, at the moment from the Treasury point of view, we are keeping a close eye on the way these things are done and the impact it is having on the marketplace and whether or not there are any distortions coming about as a result of the way products are being sold in the market.

CHAIRMAN—Have you received any expressions of concern particularly from fund managers about rebates being demanded by dealer groups for their particular fund to be included?

Mr Love—No, we have not received submissions or comments to that effect.

CHAIRMAN—I want to move on to the issue of promotional advertising. There have been some concerns expressed with regard to the cost of promotional advertising and whether it is legitimately a charge that can be levied on a fund and on members. That is one argument. It has also been argued in submissions that advertising costs should be disclosed to fund members. IFSA in particular has argued that the regulation of advertising 'should be transferred from ASIC to ACCC'. What is your response to each of those issues?

Mr Moore—On the first issue of whether fund advertising is legitimate, I think the relevant part of the law is the application of a sole purpose test. APRA have released a circular which outlines their approach to that. The purpose of the sole purpose test is to ensure that super fund activities are consistent with providing retirement benefits and other ancillary benefits to members. There needs to be a reasonable, clear and direct link to that. On 14 March this year the deputy chairman of APRA sent a letter to all trustees reminding them of their responsibilities in that area.

Mr Legg—On your last point about whether or not these things should be regulated by the ACCC as opposed to ASIC, our general view is that we feel comfortable with the reasons why this part of competition policy is dealt with by ASIC. We would not see merit in splitting it further and having bits transferred back to the ACCC and bits of it staying with ASIC. I think the general position, to our mind, remains that, to the extent that all of those powers relating to disclosure and the like are now ASIC issues for the financial sector generally and superannuation, we do not see a point in compartmentalising them again and taking some parts back to the ACCC. That would not seem to be a very sensible or simple outcome. It would just add to the regulatory complexity and overlap.

CHAIRMAN—What about the issue of the requirement to disclose advertising costs to fund members?

Mr Love—At the moment there is no view about whether or not that should be required. It becomes basically the management cost of a fund overall. There is a considerable level of detailed disclosure required, and there is mandatory disclosure in regard to management costs and how that is disclosed to consumers. But, as to how you break up particular components that go to making it up, I think whether or not consumers would even notice that might be a better question—or how much they would take that on board.

Senator SHERRY—Just on this issue, though, when you look at fund annual statements, you are right—you just see administration in their accounts. You do not see advertising. But a member of a fund can by right, as I understand it, go and get the annual accounts, which are much more detailed and in which, under accounting standards, advertising would be included. They could do that, couldn't they, if it is not actually in the annual report?

Mr Love—You are right, if it is in the financial statements. I do not know whether advertising would be shown specifically in a line item as advertising. When you look at financial statements—

Senator SHERRY—In annual accounts?

Mr Love—often they might put it in under communication or office admin or something like that.

Senator MURRAY—It is highly unlikely in the public accounts for advertising to be separately identified.

Senator SHERRY—No, not in the public accounts in the annual report, but in the company accounts—

Senator MURRAY—Even there—if you look at a normal company's accounts, they do not pick it up. They might do it in the internal chart of accounts, but, in their reported accounts under accounting standards, they would not do it. It is highly unlikely.

Mr Legg—I am not an expert on the disclosure issues, which are laws per se, but the general issue here is whether you have good reason to add another level of prescription. Is this especially special that you need to carve this out and prescribe it? I think in the whole discussion we have had—and we have had previous ones—about the degree of prescription, rightly or wrongly, FSR legislation suggests that you have to be very careful about how much you prescribe and whether or not you are making things worse or better in producing an outcome. I think you would tread cautiously before you decided to prescribe another level of disclosure. It is all a matter of balance all of the time.

CHAIRMAN—That perhaps brings me to my next issue—that is, the cost of compliance. I think that a significant number of complaints and submissions about the cost of compliance are that it is excessive. I note that, in your submission, you indicate that the government is reviewing requirements on data collection, breach reporting and responsible purchasing regimes relating to both ASIC and APRA. Can you perhaps advise of progress on that review and generally your response to this complaint about the cost of compliance? Are there areas where we can initiate change that will reduce the cost of compliance?

Mr Legg—The government's major initiatives in this area are basically captured in response to the regulation task force report. That is where many of those things that you have just mentioned are picked up. There are specific recommendations there which are being addressed, but also there is a layer of cultural change, if you like, which needs to be addressed. Perhaps it is not change but, rather, reinforcement of the right distribution of risk between regulator and regulated, if that is the right way to put it. The government is very conscious of that and is looking at a range of tools so that it is made clear in the statement of expectations to regulators about the levels of risk tolerance, and then will tackle specific issues of the type you mentioned.

Some of the response to compliance generally was picked up in the announcement that the parliamentary secretary made the other day. Other issues such as the breach reporting are part of proposals which we are developing, giving effect to government's response to the report. They are being considered by government now. I think it is sooner rather than later that they will see the light of day, but I just do not know exactly when. I do not think they are very far away.

The common business reporting framework is an issue that our secretary and the heads of the various regulatory agencies attach a lot of importance to; they are all actively involved in that. I

think it is going to be difficult to do. It is going to be worth doing but, technically, it is going to take a long time to deliver.

CHAIRMAN—One of our witnesses said changing super funds is almost as hard as changing banks; it takes 18 months to fill in the forms. What is your response to that claim? Is portability of super an issue of concern?

Mr Legg—I think the government would think that portability is always an issue to be conscious of. Portability is at the heart of what makes competition work. The government is as conscious of that for superannuation as it is for banks—and the Treasurer has recently made some comments about the cost of switching banks. I will leave it to my revenue group colleagues to talk about where the responsibilities lie, but there have been a number of initiatives taken and, hopefully, they will continue to produce results.

Ms Lejins—As part of the plan to simplify superannuation it is proposed that a new standardised form will be introduced to facilitate the transfer of benefits between funds. Significantly, the maximum period in which the transfer must occur will be reduced from 90 days to 30 days, and trustees are also going to be required to follow up incomplete requests for transfers. The ATO is also going to have a more proactive role in supporting the consolidation of lost member accounts.

Senator SHERRY—But, even with the standard form for portability, we still have exit fees in this system, don't we?

Mr Legg—I believe there are exit fees, yes.

Senator SHERRY—I certainly believe there are exit fees—about half a million. Isn't it still legal—and I have looked at some funds' recent PDSs—to have the old type of exit fee, which is the 50 to 100 per cent penalty if you withdraw? These fees largely do not exist any more, going forward, but, from looking at PDSs, I see it is still relatively common that, if you take the money out—portability—you are penalised 25 per cent in the first year, 20 per cent in the second year and phasing down to nothing after four or five years. That is still relatively common, isn't it?

Mr Legg—I do not know. I accept your view that it is. I have not done any survey to see, but it could well be so.

Senator SHERRY—Why do we have exit fees in the system at all—going forward? You cannot retrospectively abrogate contracts, but it is blindingly obvious that they are anti-competitive.

Mr Legg—I think they could be, but I do not know that it is blindingly obvious that they always have to be. I have thought more about this in the area of banks recently than in the area of superannuation. There is a fair amount of work going on in the OECD about this issue in banks. There are some exit fees, not just in Australia per se but in another jurisdiction, that are not related to any real administrative cost. There are other exit fees which may well be related to administrative cost or penalties incurred by the bank when you unwind certain investments—and these probably genuinely need to be paid. I have not done the work on this yet. I accept that it is an important issue, but I think you have to ask those questions in the super area as well—

whether there are investments being unwound that justify different penalties over time. That is the question you would have to ask and reach a judgement about.

Senator MURRAY—Senator Sherry is quite right that exit fees should be prohibited going forward. The whole area comes into question because of the absence of a fee. If it were genuinely an administrative fee, you would have entrance fees as well. The cost of establishing an account is there, but nobody charges an entrance fee, because they want your money. An exit fee is designed to prevent mobility; it is designed to take a cut as somebody leaves. If it were a straightforward cost, you would have an entrance fee. Is the government actively looking at the possibility of prohibiting exit fees?

Mr Legg—At the moment there is no active consideration being given to prohibiting them. There is an awareness of the need to look at portability issues and this would be one of the issues that need to be addressed. I speak as someone who perhaps has more recent personal experiences with banks; I have changed some accounts recently and refinanced. You get deferred administrative fees, if you like. If you set up a mortgage, they say: ‘We would charge you X but we won’t. If you pull out within a few years then you incur that cost.’ You can say that is anticompetitive or it is nonetheless a valid commercial tool by the bank to attract your business. I have benefited from it by not having to pay the fee up-front. If I continue to get benefit from that service then it is worth my while staying there. It may still be the case that the cost actually relates to the genuine cost of administration.

Senator SHERRY—Is it less valid in a compulsory superannuation system, particularly where the majority of members default to a fund?

Mr Legg—It may not be less valid where you have choice and fees can vary.

Senator SHERRY—What about where you do not have a choice of fund?

Mr Legg—I understand your view that there are a large number of significant players who do not have choice. I am not across those numbers because it is not within my bailiwick but nonetheless in principle where you have choice I think these issues become more significant.

Senator SHERRY—Just coming back to you, Ms Lejins, you have mentioned this standard portability form and lost super money. How do you overcome inertia in a compulsory system?

Ms Lejins—I think it is always difficult and it is obviously very much a matter of better educating and informing the public, but the government also announced as part of its plan to simplify superannuation a number of improvements to the operation and effectiveness of the lost member arrangements.

Senator SHERRY—We have had three initiatives in the last 10 years on this. Now we are going to have the fourth, which is the ‘send out the form’ solution. We have had some publicity campaigns, lots of glossy and fancy press releases and minister after minister making announcements, but the problem gets worse year by year. It does not get any better. Can you tell me that the ‘send out a form’ initiative in the budget papers will reduce the quantum and number of lost member accounts?

Ms Lejins—It is a matter for the ATO, who will be administering that program, to comment on the effectiveness of it.

Senator SHERRY—Do you believe it will be effective?

Ms Lejins—Obviously the more you do, the more effective you are going to be.

Senator SHERRY—Just on that statement or claim you have made, the government has done a lot in the last 10 years—I can remember three programs on this—and yet, in the last financial year, the quantum of lost super accounts increased by $1.5 billion to $9.7 billion and the number of accounts went up by 300,000. How can your statement—the more the government does in this area the more it will reduce the problem—be true when the problem has got worse year on year?

Ms Lejins—As stated in the plan, the ATO will be given a more active role in facilitating the consolidation of these.

Senator SHERRY—That is not an answer to my question. You made a statement that these initiatives will reduce the problem, but it has not happened. The problem has got worse year by year, hasn't it?

Ms Lejins—It is a matter for the ATO to comment on that. I do not have the figures or data.

Senator SHERRY—You chose to comment, which is why I am going to challenge your comment. As a matter of fact, the number and value of lost superannuation accounts has increased significantly year on year over the last 10 years, hasn't it? It is a matter of fact.

Ms Lejins—I am not aware of the actual facts.

Senator SHERRY—How could you make your comment earlier then?

Ms Lejins—My comment was to the extent that obviously if you do more to assist people in identifying their lost accounts then the less likelihood there is going to be that there will be lost members in the system.

Senator SHERRY—The problem is that there are more lost members in the system. Maybe you should go and look at the numbers. I am just challenging your assumption.

Ms Lejins—The system has grown also over that period and so it is not simply an absolute figure.

Mr Legg—That was the point I was going to make. I am not across these numbers but the sensible comparison would be the amount in this registry relative to the size of the—

Senator SHERRY—It has not changed.

Mr Legg—I do not know the answer to that. But I think that is more relevant than absolute numbers.

Senator SHERRY—Even if we take the percentage comparisons of asset and number of accounts, it has remained relatively stable. It has not improved.

Mr Legg—You asked the question at the start: how do you address inertia? Obviously, by its nature you can lead horses to water but you cannot make them do things.

Senator SHERRY—You can make them. The fundamental underwriting of superannuation is compulsion, isn't it? We make them save.

Mr Legg—That is one part of it. But even if people are aware of the choices available to them, their rights and where the funds are, inertia is sometimes a rational thing for individuals if the benefits of being interested do not really outweigh the costs. This goes back to the switching issue. Inertia might be rational and there might be a certain level of inertia which is just always going to be there and we just accept that.

Senator SHERRY—I agree with your comment that there could be a certain level of inertia. Within the inertia category, if you like, it is entirely rational to do nothing. It is an active decision to do nothing. However, the fact remains that these lost accounts are a major structural problem in our system and a major cost, and it has not got any better. That is the fact, isn't it?

Mr Legg—I accept that you see that as a major structural issue.

Senator SHERRY—Talking about education, I look at a lot of the notices that go out. Every fund is constantly urging and attaching these forms. They are not standard at the moment but they are pretty simple. They are a lot simpler than a lot of the other work in the PDS area yet a significant proportion of people do not fill them in, do not return them and do not follow the procedures, do they?

Ms Lejins—I am not in industry so I cannot comment on response rates. It is something that I do not have any information on.

Senator MURRAY—That brings me to a view that I think is apparent and that is that consumers are left out of this whole process to a great extent. I make that remark because of the sheer weight, power and strength of the industry in terms of submissions, commentary and so on. The consumer is poorly organised and poorly represented; it is almost always a kind of third-party interpretation. Mr Love, when you want to find out about what consumers are thinking, the industry tells you what consumers are thinking. It is the same with Ms Lejins; it is the same approach. If that is my interpretation of the reality of things, do you think the government in its broadest range—Treasury and APRA and so on—should be doing far more to establish just what motivates consumers, what they need and what the reality is? For instance, we have discussed inertia and the fact that consumers might be taking a rational view. They know their money is somewhere and they are happy to leave it. Or there are the issues of exit fees, or the issues of comparability and readability. Does the committee need to be asking the government to invest far more in helping consumers come forward with an expression of their views rather than relying on the present process which is an industry interpretation and industry driven?

Mr Love—Treasury are very careful about balancing out the inputs that come to us from various sources. As you quite rightly point out, industry, being very focused, with very major

interests here, is well able to present its own arguments very effectively and very forcefully. One of the major roles I see Treasury playing in this process is to balance those sorts of inputs out, and a lot of our time is spent looking at things from the consumer's point of view.

We are all consumers ourselves and vitally interested in these things. When we talk about the issues about switching and looking at forms and all the rest of it, those types of matters are things we deal with individually and discuss and look at very carefully. That is the point about designing a standardised form, for example; that type of thinking is very much driven by Treasury looking at what the types of problems are, based on our observations of the world and the information that is coming to us.

As Senator Sherry quite rightly pointed out, if you look at the types of forms at the moment and the way, for example, industry promotes switching into their funds, they are very keen to tell you to do that but, if you look at the way the information is presented, it is quite difficult to do it. I have sat down with friends and gone through the forms and tried to explain them and been confused myself. That is why, for example, Treasury gets very focused on looking at how we can present the information in a more standardised form, to give it in standardised formats, to make things simpler for people.

Senator MURRAY—I am not satisfied with your answer. That is not a criticism of your answer; it is simply because in the whole discourse that I as a legislator and a committee member have with various people, I just do not accept that the consumer ever gets the same representative weight, the same voice, in this area as does industry. The question is not that you can ever balance those up, because I think the costs would be enormous, but how much more you could balance it up.

Behind my thought is the question of whether government could practically mandate certain requirements from the industry in providing its services—namely, general principles criteria could be laid down that material provided should be readable, comparable and understandable, and that they would need to verify that to the appropriate regulators. So you just put the onus on them.

To an extent, that is done with other products. To an extent, legislators say: 'All right. Trucks have to have certain safety features and be able to perform in a certain way. How you do it is up to the manufacturer, but it has to be able to stop in a certain braking period and to be able to carry a certain load on the axles, and so on and so forth.' Is it possible to be more mandatory in this area on general principles than we are at present?

Mr Love—Our starting point is to be very cautious about being overly prescriptive and mandatory because experience has taught us that that often ends up being counterproductive and we go into a lot of problems with just trying to micromanage things which are probably beyond most bureaucrats' or regulators' capability. Often when we have gone down that road in the past—

Senator MURRAY—So why do you do it with truck axles then?

Mr Love—If we are using that analogy, I would say that our system, in relation to superannuation, does already do that. It gives the design parameters for the products, it provides

the sorts of environment in which they have to work and the prudential framework in which they have to work. A lot of that—

Senator MURRAY—Where does it say that a product must be readable, understandable and convey comparability?

Mr Love—We do say it has to be clear, concise and effective.

Senator SHERRY—Probably because we haven't got it!

Mr Love—Then we can get into discussion about whether or not the trucks look as good or all the controls in them are as easy to use as in another truck. That is very much the designer point of view. What we are trying to give the consumer is the ability to experience whether or not that particular truck or, from the consumer point of view, a car is easy and manageable to drive on the road. That is all being driven by the person who has made the product; it is all that sort of soft stuff which attracts you to buy, for example, a Holden or a Toyota. That is driven by design and the market and the product manufacturer themselves, which I think is a way superannuation works as well. We have provided that design framework; certainly there is a clear bounded box into which you have to design your products.

Senator MURRAY—There are two competing theories. One theory is that because the market is competitive and been made more competitive—which it has been through choice, the FSR and all that sort of thing—the industry will themselves come to design things which are more and more attractive to customers in order to try and draw custom. That is standard competition theory. The other theory is that it is against the interests of the major players to encourage these things so they put impediments in the way of making things readable and understandable and comparable. Governments recognise that; it is the very reason we have got a mandated fees and disclosure system. I listened to your response on nomenclature, Mr Love. Frankly, from the customers' point of view, they understand 'agent', they understand 'franchisee' and they probably will understand 'fee for service', although that will not be as common in their experience, but they do not understand the stuff you responded with. I just do not think there is enough consumer input into this whole area. We are relying on competition theory. I agree that we cannot prescribe exactly in many areas, but we can lay down principles. I wonder if Treasury, government and perhaps legislators are a bit closed minded about this and are unwilling to really consider the alternative, and that is to lay down core criteria or principles which should be met.

Mr Love—I think our system does, as I said, lay down a lot of those basic criteria, certainly when we have been looking at the system. You talked about the consumer side. One of the main inputs that comes to Treasury in relation to looking at it from the consumer point of view, apart from the experience we have ourselves as individuals, is very much driven by the types of complaints, by the problem areas where the problems arise. As you would know as a legislator, you get a lot of feedback from the marketplace simply through the complaints that people are putting through to the ministers. That is something that gets a lot of close personal attention from all of us in Treasury in dealing with those types of things. I suppose that is a skewed sample in one way, but it tends to show you where the hot spots are with particular areas, and that often drives our close examination of particular matters as well.

Senator MURRAY—But sometimes a major problem can exist where there is almost no consumer reaction—for instance, that whole area of lost funds. I do not get people ringing me and writing to me about that issue. They do not, and they do not write to you either.

Senator SHERRY—They do write to me. I do get a few—it is in my top three, I have to say.

Mr Love—Actually, I have done a few of those letters as well.

Senator MURRAY—Accepting that there may be some evidence, there are not the hundreds and hundreds of thousands of complaints, which are actually represented physically by the number of lost funds. And to me that means that the problem is about encouraging a different mindset, a different attitude, in fact being provocative towards consumers in terms of their own interests and in the national interest, which is to increase things. Anyway, let’s leave that for a second.

Mr Legg—I think we understand the problem and would share your desire to address the problem. We feel that in many ways we are trying to do that through the principle based approach to various pieces of legislation. To the extent that we have done that, we have found ourselves pushed down a more prescriptive route sometimes because of the difficulty of actually delivering that. The other point I would make is: whilst again it is a very big ask—it is a big task ahead—we have set up the Financial Literacy Foundation, which is again a recognition that a big part of this has also got to be education. That is perhaps not provocative in a way, but it is trying to raise consciousness about these issues. All of these things are just small parts of the solution, but they are important parts of the solution.

Senator MURRAY—Two questions arise to me from this inquiry and the general field. These were picked on by Senator Sherry in a specific manner earlier. The first question is: should the government—and I talk in the broader sense—be doing more through the regulators or the respective departments to do focused consumer research to try and improve this whole area? In my own mind the answer is yes, but I am not sure how or what or how much money it would involve or what sort of area would be targeted. The second question is: should we be putting more onus on industry to achieve general objectives such as I outlined? Let me move on. Mr Legg, during your discourse with Senator Sherry, you were discussing risk. I got an impression which I just want to clarify with you. You seemed to be saying that, prior to the choice reforms and the consolidation of the industry which has resulted since then, risk was dispersed through there being larger numbers of funds and more trustees and that risk is now concentrated through a smaller number of funds and fewer trustees therefore. Did I get the wrong impression or was that what you were saying?

Mr Legg—I do not think I was saying that. It is an interesting idea, but I certainly was not attempting to say that. I am not certain exactly what I said that led to that.

Senator MURRAY—I tried to interject but I lost my opportunity.

Mr Legg—I do not think that risk is more concentrated. I think the smaller number of licensed trustees are obviously managing a wide range of investments, which may well result in the same diversification of risk. They are obliged to have uniformly more stringent approaches to risk management than they had in the past, and that is unambiguously a good thing. One point I

was making earlier was about risk tolerance in society, and that is about the approach the regulators take and the guidance that the government gives the regulator. That is something that was brought up in the Banks report, and there was an attempt to try and address it through statements of expectation.

Senator MURRAY—My own impression is that it is not a problem. My question would be: has greater concentration and the larger aggregation of moneys in particular funds under management by fewer trustees increased risk in this area?

Mr Legg—I would not have any a priori reason to assume so.

Senator MURRAY—I would not either.

Mr Moore—Time will tell, because we are still bedding down the new trustee-licensing arrangements and the minimum standards that were introduced with them. One argument you could run around this issue of aggregate risk is that, because we have a smaller number of much more professional, better-run funds, the people for whom it was not their core business and maybe were not up to the task have dropped out of the system and, because it is better managed, aggregate risk could go down.

Senator MURRAY—Because the question would be: if there were greater risk, would you have to adjust the capital adequacy circumstances, because the collapse of a very large player would have so much more market effect? My sense of things is that you would not.

Mr Moore—The capital adequacy requirement attaches to the trustee, and the assets of the trustee must be separate from the fund.

Senator MURRAY—Yes, but you only ever look at adjusting capital adequacy relationships in the risk environment; there is no other purpose to it. On the question of risk with respect to SMSFs, I often think that we tend to compartmentalise superannuation analysis. My sense of things is that probably many people with SMSFs have themselves laid off the risk that they would have outside of their SMSF relationships—probably super funds in a general sense, probably annuities and other forms of investment. Has Treasury done any work to see how far retirement planning by consumers who have SMSFs is arranged across a group of what we could call securities—whether they do have annuities outside the SMSF; other super funds and other investments? Because, of course, that comes then to risk. If the assumption is that SMSFs is a more risky sector by virtue of the statistics we have and the way in which they are being run and managed, that inclines people to think that it needs much more regulation. But if the reality is that the way in which these interrelate with other retirement income strategies is different to that perception, then the risk is lowered.

Mr Legg—I am not aware of whether Treasury has done that work. Certainly in my time in this job I have not seen any results of that sort of work. Erica wants to add something.

Ms Lejins—As we pointed out in our submissions, self-managed funds do provide a greater degree of control and flexibility compared to other arrangements. This is perhaps one of the reasons why we are seeing the growth in the self-managed fund sector and why some retirees are choosing that.

Senator MURRAY—I think you miss the point. The point I am making is that greater regulation of SMSFs has occurred and there is more argument for that to be increased. I think that is an unwise route to take until such time as we understand the placement of SMSFs in the whole mix that is available. My question to Treasury is: are you doing any basic research to establish a typical profile?

Mr Legg—Do you mean whether someone who has an SMSF has other investments—what is the balance of their investments and the overall risk they are taking?

Senator MURRAY—That is right.

Mr Legg—I am not aware that we are doing that work. Your basic point is that we have tightened up on regulation in the SMSF area. I think what we are trying to do is tighten up on the application of existing regulation. There are a few small changes. But the general principle is that SMSFs are people's own money and therefore have a lower level of prudential regulation if you like than APRA would apply. No-one is suggesting that should change.

Senator MURRAY—I would like you to take on notice this question: does Treasury think there is any value in doing some basic research to establish whether SMSFs are regarded as just part of an overall retirement income strategy or if they are regarded as the principal retirement income strategy by consumers? My instinct is to the former and not the latter, but I do not know. In other words, is it an all-the-eggs-in-one-basket approach?

Moving on to another sector in your submission which concerned the not-for-profit regulatory issue, I have done some fundamental work in this area which I have advised Treasury and others of, but my general concerns about not-for-profit regulation do not apply that much in superannuation. My feeling is that the difference between not-for-profit and for-profit entities in terms of their reporting, their legal responsibilities and their prudential characteristics does not matter that much because APRA is covering the field—it is not an area where we have to be greatly concerned that some will be classified as for-profit and some as not-for-profit.

Mr Moore—I think we would agree with that.

Senator MURRAY—Good; thank you. This committee did what I regarded as a very good report on insolvency reform. The government have just announced that they will finally advance reform to that law. That may improve the protection of employee entitlements in the event of employer insolvency. Has the Treasury done any work to establish whether there will be beneficial effects on that area as a result of these reforms they are doing? I suspect not, but perhaps you could find out.

Mr Moore—Not quantified numberings. Part of the intention is that the reforms will improve the protection of entitlements. But, as far as the quantified benefit goes, no; there is no figuring on that.

Ms BURKE—I want to put on notice at this point two things to look at. The biggest issue I get of concern is when someone leaves their employment—it is not just insolvency—and the employer has not paid their super. Getting the ATO to follow it up—it is not the ATO's problem—or getting the employer to actually pay the money that they should have been given is

virtually impossible. So (a) it happens obviously in insolvency but (b) it happens a lot to people, period. Their company is still ongoing and getting someone to pay. Should it be paid more regularly? Should your SGC contributions be paid monthly? Does Treasury have a view on that one? And should super now form part of the GEERS as well? As I say, I do not want you to answer it now. It is a follow-on. With compensation, the No. 1 complaint would have to be from people who suddenly leave their employer and discover their money is not sitting in their super fund as their employer has told them.

Senator MURRAY—I like those questions on notice. One of the areas I wanted to go to, and to add to that question on notice, is as follows. People like Senator Sherry may have a better feeling than I do, but I have the sense that the unpaid super area, where employers just have not done the right thing, is far bigger than is known. That is not the question on notice. My question on notice is: with respect to the new insolvency laws, will Treasury have a mechanism to assess whether the effects are beneficial once that law comes into place in increasing the entitlements being paid that were formerly lost? I have expressed that rather badly. What I am concerned about is that the existing insolvency law results, I think, in a situation where entitlements are lost, and I hope that the changes will mean that they are not lost to the same extent. I am really asking about a monitoring process once the law is in place.

Senator SHERRY—I think I put a similar question on notice to the ATO about what is the actual amount that is lost in super as a consequence of insolvency year by year.

Senator MURRAY—And whether that will be reduced.

Senator SHERRY—I suspect you will go to Treasury for that. You may have an alternative source, but if you go to Treasury it is on notice there as well.

Senator MURRAY—I am conscious of having expressed that badly. I just want to be sure that, once the law comes into place, we have a before-and-after sense of things and that we have improved it. I will leave my questions there. Thank you.

CHAIRMAN—Thank you. I thank the Treasury for appearing before the committee. I understand you wish to stay here for the tax office’s appearance.

Mr Legg—We are happy to stay.

[11.01 am]

FORSYTH, Mr Stuart, Assistant Commissioner, Superannuation, Australian Taxation Office

VIVIAN, Ms Raelene Susan, Deputy Commissioner, Superannuation, Australian Taxation Office

LEGG, Mr Chris, General Manager, Financial System Division, Treasury

LEJINS, Ms Erica, Senior Adviser, Superannuation and Retirement Savings Division, Treasury

LOVE, Mr David, Manager, Investor Protection Unit, Corporations and Financial Services Division, Treasury

MOORE, Mr Andre, Manager, Prudential Policy, Superannuation and Insurance Unit, Financial System Division, Treasury

CHAIRMAN—I welcome the representatives of the Australian Taxation Office. The committee has before it your submission, which the committee has numbered 36. Are there any changes or additions you wish to make to the written submission at this stage?

Ms Vivian—I have no changes to make to the submission.

CHAIRMAN—In that case, I invite you to make a brief opening statement, at the conclusion of which I am sure we will have some questions.

Ms Vivian—Thank you. The role of the tax office in this area is to ensure that self-managed funds comply with the provisions of the SI(S) Act and its associated regulations. We see we have a clear role as the regulator of self-managed funds to ensure a fund complies with the legislation in its establishment and operations, ensure the fund's primary purpose is to generate a retirement benefit for its members, check that the fund is managed in line with the rules and regulations of the relevant legislation, review the work of approved auditors, ensure trustees meet their own taxation obligations and ensure that trustees have an investment strategy.

In the 1998-99 budget, the government announced its adoption of the recommendation in the final report of the financial system inquiry—the Wallis report—that, from 1 July 1999, super funds with fewer than five members that had members as trustees would be regulated by the tax office. That policy objective was to ensure that all members of excluded super funds were able to protect their interests. The actual transfer of the regulation of self-managed funds from APRA to the tax office took effect on 10 October 1999. At that time, 187,000 funds transferred from APRA to the tax office. Since then, the number of self-managed funds has grown to about 320,000, as at the end of June 2006. In 2005-06, the net growth of self-managed funds was by about 16,400. From 1999 to 2006, assets have grown from about $70 billion to $209 billion.

Currently we have 292 staff working on self-managed funds at a cost of around $30.4 million. In performing our regulatory role, we provide information, education and advice to help trustees understand their obligations; audit funds at high risk of not complying; check member contribution statements to check that all contributions are reported correctly; review high-risk regulatory issues; and follow-up auditor contravention reports. The key risks for self-managed funds currently are trustees not fully understanding their obligations, unauthorised early access, personal use of fund assets, breaches of in-house asset rules, acquisitions of assets from related parties and failure to lodge complete and accurate returns. That is all.

CHAIRMAN—I note in your submission that, among the typical errors that you record in relation to compliance, funds incorrectly state that an approved auditor has conducted an audit of the fund when this has not occurred. What percentage of funds would be in the category of a lodgement compliance issue?

Ms Vivian—I do not think I have information down to that level of detail. We collect the range of issues but do not necessarily record the percentage against each error reported.

CHAIRMAN—The reason I asked that question is that, if funds are not audited, you may well expect other lodgement or information errors to occur.

Ms Vivian—Certainly. We conducted a benchmarking survey and it showed that 70 per cent of auditors audit fewer than five funds. We found that auditors do a very good audit of the financial accounts but their knowledge of the SI(S) Act seems to be lacking.

CHAIRMAN—That in part answers the next question I was going to ask, which is that you might expect errors to occur with funds that have not been audited, but with funds that are being properly audited you would expect that some of these errors would be picked up and corrected in the audit process before the returns were lodged. I was wondering why you still seem to be getting errors in the lodgement information in those funds that are being audited. From what you have said, the auditing itself is not being conducted on a proper basis by the auditors.

Ms Vivian—I have just found some further information on the contravention percentages. What we find at the moment is that, when auditor contravention reports are lodged with us, about 50 per cent of them are rectified. We do some work to follow-up and check whether they have been rectified. In terms of your initial question, although not specifically on that one, the following are the major reasons for contraventions, at a percentage level: 18 per cent are about loans to members or relations; 16 per cent are about assets not in the name of the fund; 14 per cent are about breaches of in-house asset rules; 11 per cent are about documents requested by the auditors that are not provided; nine per cent are about borrowings for self-managed super funds for purposes not allowed by the legislation; and about eight per cent are about a breach of the sole purpose test. They tend to be the highest ranking contraventions reported to us.

CHAIRMAN—Included in the recent budget reforms announced to superannuation generally was the increase in the administration fee for self-managed funds. There was about a trebling of that fee. How are you going to apply the additional revenue that will generate?

Ms Vivian—Most of the additional revenue that will be generated will feed into work on our compliance area. The funding we received, particularly in the first few years, was probably in

excess of the fee. Over two years, we will be moving the number of our active compliance staff from approximately 150 to 500. This will see an increase in coverage across the fund market from 1.2 per cent to about three per cent. Plus, we will start doing a seven per cent coverage of auditors each year. So, over three years, we would look at about 20 per cent of the auditors to see how they do their jobs.

CHAIRMAN—Your submission has a pie chart showing the SMSF investments held in asset classes. One of the concerns that has been expressed is that a lot of self-managed funds have cash lying in them instead of investing it in assets that might grow to provide retirement incomes. If you look at what I suppose is broad advice on asset investment, you will see that one parameter used recommends a third in cash, a third in shares and a third in property. Your pie chart looks as though it is roughly complying with that broad investment advice. Is there a concern about the investments that are being made or about the lack of them by super funds?

Senator SHERRY—But, in a default investment environment—I am talking about other super funds—you do not have anywhere near the commonly accepted benchmark of 30 per cent in cash, do you?

CHAIRMAN—No. I was going to go on to that.

Senator SHERRY—Sorry.

CHAIRMAN—That broad investment advice is probably in a situation where people may want access to their cash—and, of course, they do not have access to their assets in a superannuation fund until retirement. In that context, what is your view on appropriate investment strategies for self-managed funds and to what extent do you think funds are complying or not complying with an appropriate investment strategy?

Ms Vivian—As regulators, we do not have a view about what their investment strategy should be; our role is to ensure that they have an investment strategy. I would point out that the reporting of the information is based on what is put on the return forms that come into us. So, sometimes, what gets recorded there is how the trustee or the agent who prepares the return might classify their investments.

CHAIRMAN—I also note that, as at June 2005, the average asset per member was something in excess of $285,000. The number of members per fund may be up to four, so that could mean an average of between half a million dollars and over $1 million in a self-managed fund.

Ms Vivian—As at 30 June 2006, the average asset per member had grown to $340,000.

CHAIRMAN—So the average asset in a fund is well over what might be regarded as the minimum level required to make a fund viable in terms of admin costs and the like. One concern that has been expressed is that many funds do not have adequate assets to make them viable in terms of admin costs. You have given us the average figure, but do you have the figures on how many funds total assets might be less than what might be regarded as a viable figure for admin purposes?

Ms Vivian—As at June 2006, the average total asset per self-managed super fund was about $653,000. In answer to a question on notice from Senator Sherry, we said that $200,000 is often regarded as being the level of viability. That answer was based on the 2003-04 year and I think it showed that about 40 per cent of self-managed super funds had assets under $200,000. In the last year this figure has shifted to about 34 per cent of funds.

CHAIRMAN—It has fallen.

Senator SHERRY—That answer was in reply to a question at estimates, not at this committee, so neither the chairman nor the other members of the committee would be aware of the answer you gave me. Could you update that information and provide the answer on notice to this committee?

Ms Vivian—Certainly.

CHAIRMAN—So the percentage of funds that are below the 'efficiency threshold', for want of a better term, is falling?

Ms Vivian—Yes. So maybe you could draw the conclusion from that that these funds are in an accumulation phase. I have looked a bit more closely at them because it is a concern whether these funds are at risk. From memory, about 50 per cent of the funds were set up before 2002, so they have been set up for some time. A very high proportion of them use a tax agent; it is higher than the average for self-managed super funds.

We are certainly having a closer look. When I have talked to people and looked across the audits we have done, I have tried to see whether there have been any more compliance risks or contraventions occurring in funds with over $200,000—and I do not have any evidence to say yes or no. They seem to be part of the norm in terms of what is reported. But this year we are going to have a closer look at some of them to see if there are any particular risks there. I suppose what we do see when we look at them is that they have quite a few contributions coming in, either personal or from employer contributions and, on that recent stat, most of them are in an accumulation phase; very few are paying out pensions.

Senator SHERRY—In the information that you provide on notice, could you also update the average fee. I think in that information you gave me there was a fee for the range of balances, which is always useful.

Ms Vivian—Yes, I have some information here I can give you on it, although, in giving you an average—

Senator SHERRY—You can give me an average if you have it, but I am always a bit suspicious of averages, particularly across a range of balances. And there is a range of fees and—

Ms Vivian—We had a look at funds with total incomes of, say, zero to $5,000—so, very low. When we look at a range of them we find that the maximum fee that would be paid would be no more than $250. So the majority were paying a maximum of five per cent. I would say that that plays out in all of them. We then looked at funds with a total between $5,000 and $10,000.

Again, most of the funds reported a management fee in the one to five per cent range. So the maximum fee there would have been $500.

Senator SHERRY—That is a management fee. It is not a set-up fee, is it?

Ms Vivian—No. I will certainly see if we can pull that information—

Senator SHERRY—That would be interesting.

Ms Vivian—but I suspect we do not collect that information.

CHAIRMAN—The SPAA and, I think, several other submitters to this inquiry have proposed an increase in the maximum number of SMSF members from four to nine. What is your view on that proposal?

Senator SHERRY—Double your workload. Triple it!

Ms Vivian—Certainly it would change our workload. I think that would be a matter for Treasury to comment on.

Senator SHERRY—Sorry—this is on the alleged basis that families are growing: 'We have nine people in the family now and, therefore, we need bigger SMSFs to accommodate this explosion in family growth.'

CHAIRMAN—You might want to include marital partners—

Senator SHERRY—Yes, and their kids, and the two or three marital partners you have had, and the grandkids, and the extended families—and same-sex couples; we should not forget them, either.

Ms Lejins—Any change to the rule would ultimately be a matter for government, but I would just like to point out that it is not only that self-managed funds have fewer than five members; there is also a requirement that all members of the self-managed fund be trustees. That is intended to ensure that the funds are genuinely self-managed and of sufficiently small size that all members can be involved in the decision making process of the fund and are able to protect their interests. In a larger fund, the decision making process would be considerably more difficult and would generally involve one or more members forgoing representation.

The other thing that I would like to point out is that in some state legislation there is a limit on the number of trustees that you can have. In some jurisdictions there is an absolute requirement not to have more than four trustees or four individual trustees. So there is also a natural cap elsewhere.

CHAIRMAN—If you had a corporate trustee, that would overcome that problem.

Ms Lejins—Yes; if you chose to have a corporate trustee that would overcome that problem. But we do allow members to be individual trustees.

CHAIRMAN—Accepting your point that members have to be trustees, do you accept that it makes sense to have a family group all in the one fund rather than having to set up a series of funds essentially for the same purpose with extra compliance costs, admin costs and the like?

Ms Lejins—I think it is recognised that the membership limit does prevent more than four family members being members of a self-managed fund but there is no limit—they could choose to set up a non self-managed fund as an alternative, and they could set up a fund that would be subject to APRA regulation. Ultimately it is a matter for government, not a matter for Treasury.

Senator SHERRY—They can set up a fund but it is effectively APRA regulated?

Ms Lejins—Yes, it is APRA regulated.

Senator SHERRY—And obviously with an APRA regulated fund, certainly in all the evidence I have seen, the level of trustee training, knowledge et cetera is considerable.

Senator MURRAY—I have a question—and I am sure I know the answer—on the same point that the chairman was pursuing. Has the ATO done any work to establish how frequent the multiplicity of SMSFs is with respect to close family? In other words, do you know, out of the growth rate in SMSFs, how many in fact represent the problem that the chairman outlined—that is, that extended families are forced to create more than one fund because of present regulation?

Ms Vivian—No, we have not done any work on that. It would be difficult because you would have to make some guesses about names. I am thinking about whether we could even provide anything that gave you an indication. I think one of the issues would be that we would not be necessarily aware of all the family relationships in the fund—unless they were to call it Smith family No. 1 and Smith family No. 2 or something along those lines.

Senator MURRAY—Would it be difficult or costly to do some snapshot research? In other words, would it be difficult to take a slice of 500 funds and establish on a random basis how many—

Ms Vivian—It would be costly if we had to contact them. I am happy to take it on notice and see if we can do a snapshot based on registration information. But, as I said, I would couch it as indicative only, because all we could search for would be similar sorts of names.

Senator MURRAY—On the chairman's point, I am sympathetic to the idea of larger numbers being possible for close family members; but I do not have an idea of how big the problem is. I do not have an idea of how many families are forced to create more than one fund.

Mr Forsyth—The bulk of funds have fewer than four members. I think you would find that most funds have two. So it does not look like everybody is pushing up against the four barrier. There are people who are members of more than one fund but that does not mean that they are members of more than one fund with their partner and with their children. So it would be difficult to work out if you had a fund for your children, and only the children were members of that fund, and the older generation were members of another fund. I am not sure how we would work out the association between those two funds.

Senator MURRAY—Perhaps you could come back to us with a broad sense of how or at what cost this particular area of concern could be assessed, because I just have no feel on this. I do not know whether anyone else on the committee does.

CHAIRMAN—In relation to compliance, in your submission you indicate that you take a risk based approach to compliance and you also say that 75 per cent of high-risk funds have medium to serious compliance issues. What proportion of funds do you class as high risk and have you done any analysis of the level of compliance issues faced by what you might term medium-risk funds?

Ms Vivian—Are you referring to the tax office submission?

CHAIRMAN—Yes.

Ms Vivian—I do not think it is in the tax office submission.

Senator MURRAY—At item 2, you talk about identifying high-risk funds. Mr Chairman, is that what you are referring to?

CHAIRMAN—Yes. On page 7 of the tax office submission, under item 2, 'Active Compliance', it says:

While we are still evaluating the 2004-05 audits, results so far show that of the funds identified for audit using the Risk Assessment Profiling Tool, 75 per cent of those rated as 'high-risk' were found to have medium to serious compliance issues.

Ms Vivian—I am just trying to work out which document that is from.

CHAIRMAN—This is from a speech by the Commissioner of Taxation on 1 March 2006.

Ms Vivian—Thank you. What were the terms of the question?

CHAIRMAN—You indicate in your submission that 75 per cent of those rated as high risk were found to have medium to serious compliance issues. The question was: what proportion of funds do you class as high risk, do you have a class of funds that you regard as medium risk and, if so, have you done any analysis on the level of compliance issues that they face?

Ms Vivian—I do not have the break-up here between high risk and medium risk. Given that in the last year our active compliance work has been at about 1.2 per cent, it has been focused on the high-risk areas of the self-managed funds. So the areas that we have been particularly looking at are trustees, unauthorised early access, personal use of fund assets, breaches of in-house asset rules and acquisitions of assets. I can come back to you with a break-up of the 75 per cent mentioned in the speech. I would need to confirm what the break-up of that would be in terms of your question.

CHAIRMAN—The SPAA has recommended that mandatory personal indemnity insurance be introduced for trustees and advisers of self-managed super funds. Do you have a view on that proposal?

Ms Vivian—No. That would be a policy matter for Treasury.

CHAIRMAN—Do Treasury have a view on that?

Senator SHERRY—Perhaps they could indicate whether, in the discussion paper on PI insurance, SMSFs were to be included. I have read the paper but I cannot recall one way or the other whether SMSFs were to be included.

Mr Legg—Perhaps you could repeat the question.

CHAIRMAN—A recommendation in the submission from the SPAA is that mandatory personal indemnity insurance should be introduced for trustees and advisers of self-managed super funds.

Mr Legg—And the question was whether we have a view on that?

CHAIRMAN—Yes.

Mr Love—This has been raised in regard to the compensation regulations that were put out in draft form by the government. We have received submissions on that idea, and it has certainly been looked at. The proposal is that prudentially regulated trustees of trust funds would be exempted from the requirement to hold professional indemnity insurance under the FSR licensing requirements in order to avoid duplication in regulation.

Senator SHERRY—Ms Vivian, we have discussed SMSFs on numerous occasions. I do not have any more questions on that for you today, but we will see each other again in February at estimates. In the budget super plan there is a proposal to apply a higher tax penalty on contributions for members where there is no TFN number. What is the proposed penalty level? Could you, for the record, refresh the committee's memory on that? Will it be at the highest marginal tax rate?

Ms Vivian—Yes, the marginal tax rate.

Senator SHERRY—Which is going to be 45 per cent, plus the Medicare levy?

Ms Vivian—Yes.

Senator SHERRY—Are there any other elements to that penalty? All up, as a percentage, what will be the tax on contributions?

Ms Vivian—I think it will be 46.5 per cent.

Senator SHERRY—Contributions tax is 15 per cent across the board. The penalty will be very substantial for low-income earners who pay 15 per cent. It is an increase from 15 per cent to 46.5 per cent. It is a substantial increase in tax on contributions for that group, isn't it?

Ms Vivian—Yes, it would be for anyone who did not have their tax file number applied.

Senator SHERRY—Following on from that and the discussion we had at estimates—which I refreshed my memory of last night by reading the transcript of the hearing—there is evidence that, at the moment, funds have on average 76 per cent of TFN numbers. I think that was the figure you gave.

Ms Vivian—I was quoting what was coming through the members' contribution statements.

Senator SHERRY—On average, 76 per cent of TFN numbers are held by super funds. I recall in our discussion that you indicated that, based on information held by the ATO, the figure would rise to 83 or 84 per cent?

Ms Vivian—About 83 per cent. Over the last few years, an increasing number of TFNs have come in on members' contribution statements.

Senator SHERRY—But it was not clear to me from that evidence that, where the employer has not provided the TFN number to the fund—legally they are required to provide that to the fund—but the ATO has the TFN number, the ATO would notify the fund.

Ms Vivian—The government has provided some funding for us to write to the member and let them know. At the moment, under privacy legislation we would not be able to provide the tax file number directly to the fund.

Senator SHERRY—Given that effectively you will not be deeming a group of people to have their tax file number, the tax penalty will not apply. There is no way that you can deem that information against the individual and not have the fund collect it?

Ms Vivian—We are proposing to write to the individual to seek their permission. As I think I mentioned at estimates, we are looking to have some discussions with the Privacy Commissioner so that we can do it in a way that maximises the number of tax file numbers that we can pass through to the fund on behalf of the individual.

Senator SHERRY—We know that, at the moment, approximately a quarter of TFN numbers are not held by funds. It varies from fund to fund. REST Superannuation has given us some interesting information on that. By the way, have you read what REST did to try to get TFN numbers?

Ms Vivian—I did read that. I think they talked about it. They got a very low response when they did that.

Senator SHERRY—We have about a quarter of members for which contributions are being paid without TFN numbers. It seems to me that, given the information you hold, if you were to send out a letter to these individuals, at best we would get another eight per cent, which would take it up to about 83 or 84 per cent.

Ms Vivian—That is possible. I think we would be striving to increase it as high as we could get it.

Senator SHERRY—But it seems to me that, on what you have given us, at best it will be 83 or 84 per cent.

Ms Vivian—If it were based on the members' contribution statements and what we can match at the moment, it would be 83 or 84 per cent.

Senator SHERRY—I do not think this information was from the ATO, but I am aware of a provision in the costings of this package for the collection of revenue as a consequence of this tax penalty.

Ms Vivian—That would be a matter for Treasury.

Ms Lejins—We would need to take that question on notice.

Senator SHERRY—Okay. You can take it on notice and let the committee know the figure. I cannot get a breakdown of the figures from the budget super plan. You could take it on notice and have another go—it is about the 50th question on this with no response. I want to know the estimated number of people who will pay the new tax penalty because their employer has not provided their tax file numbers. Given there is an estimated amount in the budget plan, what is the estimated number going forward over the forward estimates? Approximately how many people do we have currently in the workforce for whom superannuation contributions are being paid?

Ms Vivian—Lots.

Senator SHERRY—We have about 10 million in the workforce.

Mr Forsyth—It is eight to 10 million, I believe.

Senator SHERRY—I think 92 per cent is the latest ABS figure on SG, so we are looking at eight to nine million people receiving contributions. You are saying about eight to nine million, are you not, Mr Forsyth?

Mr Forsyth—That figure is familiar to me. It is something in that order. There are around 10 million employees, I believe, in the economy.

Senator SHERRY—Let us take the lower figure and say that eight million people are receiving superannuation contributions into their fund. If 10 per cent of people do not provide their tax file numbers, that means between 800,000 and one million people will have to pay this new tax penalty. That seems a reasonable calculation, does it not?

Ms Vivian—Yes, based on those figures that you provided.

Senator SHERRY—I am using a conservative figure of 10 per cent. We know that at the moment about 25 per cent of TFNs are not provided by employers. I accept that you are going to do a lot of work and that you might get that up to 85 per cent. So there could be about 15 per cent of TFNs not provided. Using that conservative figure, 10 per cent of eight million means

there could be 800,000 people who will actually get a tax increase out of this superannuation budget plan, not a decrease. Their tax is going to go up, is it not?

Ms Vivian—I suppose what I can talk about is what we propose to do here.

Senator SHERRY—I know what you can talk about, but I would like an answer to my question. There is a substantial number of people who are going to have a tax increase as a consequence of this budget plan. Whatever the figure is, a lot of people are going to have a tax increase. That is correct, is it not?

Ms Vivian—I think it is really a matter for Treasury in terms of the issue of the revenue and the policy. I can certainly talk about the different elements that we are going to use to try and reduce the number of people who would not have passed on their tax file number.

Senator SHERRY—Before we go to Treasury, there is a significant increase in tax on contributions when the employer does not provide the tax file number. That is a matter of fact, is it not?

Ms Vivian—It will be a matter of fact once the legislation has passed.

Senator SHERRY—Yes, from 1 July next year. If there is no tax file number, there will be an increase in tax.

Ms Vivian—If there is no tax file number, there will be an increase in tax on those contributions.

Senator SHERRY—Correct. For some, it will go from 15 per cent to 46.5 per cent. That is the tax penalty, is it not?

Ms Vivian—That is what is being proposed.

Senator SHERRY—But can you assure me that the ATO will do its best to minimise the number of people who will face this tax increase?

Ms Vivian—We have done some user testing to try and understand why the tax file number is not being passed through. One of the reasons we have looked at—and this will be changed—is that, at the moment, when an employee starts with an employer, they have to quite specifically elect that the employer has the right to pass the tax file number through. That will be changed so the employee will have to specifically elect that they do not want their tax file number passed through. So, with new employees, that should see a reduction in the number of tax file numbers not passed through.

Senator SHERRY—It is opt out, as distinct from opt in?

Ms Vivian—Yes. When we did testing with the employees, it was more that they thought that they had ticked the box. There was a general awareness—they thought it had gone through and seemed quite surprised that it had not been passed through.

Senator SHERRY—Let us assume that goes ahead, and I accept that it almost certainly will. What if the employer does not provide the TFN to the super fund? The employee has not opted out, so the employer has the legal ability to provide the tax file number to the super fund. If you assume that has happened, why should the employee be penalised? Why should they face the higher tax because the employer has failed to provide the TFN?

Ms Vivian—We are also going to do some work with some of the software companies that do most of the payrolls and provisions through to the super funds. It is a little bit hard to say, because I have to start doing some of the work with them, but the aim would be to try to make it more of an opt out by the employer to not provide the tax file number rather than to do it.

Senator SHERRY—I accept that. That will be good work. But, under what is being proposed, if the employee does not opt out, the employer can provide the TFN to the super fund. If the employer does not provide the TFN to the super fund, is it not true that this new penalty tax will apply to the contributions of that employee?

Ms Vivian—If the employer did not provide the tax number to the super fund, there is a penalty we could raise on the employer.

Senator SHERRY—That was not my question. We might get to that in a moment. Is it not true that, where the employer fails to provide the tax file number, the employee will pay a higher tax penalty on their contribution?

Mr Forsyth—They may. There is a $1,000 limit, as I understand it, for existing members as at 30 June next year. Then the employee could supply the TFN separately to the fund.

Senator SHERRY—Let us get back to my question—and I want a straight answer to this, please. The employer is authorised and has the legal ability to provide the TFN to the fund. If they fail to do so, is it not true that the employee—subject to a $1,000 limit in contributions—will then be subject to the new penalty tax on their contributions?

Ms Vivian—As the legislation has not been passed, it is difficult for us to comment.

Senator SHERRY—Is that not what is proposed?

Ms Vivian—That is our understanding of what has been proposed.

Senator SHERRY—Treasury, why should an employee who is a member of a superannuation fund face a penalty tax increase due to the failure of the employer to provide the TFN?

Ms Lejins—I need to take that question on notice.

Senator SHERRY—I put it to you that it is unethical and, indeed, immoral that employees—and we are going to have hundreds of thousands of them—who are members of super funds are facing a massive penalty tax increase because employers have failed to provide the TFN.

Mr Legg—I am probably the least able to comment on this, seeing as I know nothing about our tax system other than what I pay—I have spent a career avoiding working in the tax area—

but I just do not think we can react to that. We come here with people who can address the terms of reference for this inquiry. We do not have the people here to talk about the superannuation simplification plan, which was not in the terms of reference.

Senator SHERRY—Well, yes and no.

CHAIRMAN—Senator Sherry, just let Mr Legg answer.

Mr Legg—I think it is very hard for officials to discuss with the inquiry issues of morality of government policy one way or the other.

Senator SHERRY—In response to my earlier questions, Ms Lejins did volunteer reference to the budget plan. I accept your caveat to some extent, but not totally. Is any officer here aware—and I stress the word 'aware'—of the estimated number of Australians who will face this increase in tax penalty? We know there is an estimate. Is anyone aware of it?

Mr Legg—I certainly am not.

Senator SHERRY—Any of the other officers?

Mr Legg—It is not something my area has any involvement in.

Senator SHERRY—You are not aware, Ms Vivian, of the estimated number of Australians who are going to face this extra tax on their super?

Ms Vivian—No.

Senator SHERRY—You have been involved in the work in this area. I am surprised you are not aware of it.

Ms Vivian—Not in this case. I am not across everything.

Ms BURKE—I want to go back to this issue of matching and the privacy provisions and the ATO's requirement. You do matching in respect of other government departments, though, don't you? You do assist in, say, Child Support Agency and Centrelink issues. Why is there a privacy issue impediment in this matching exercise when there is not a privacy issue in the matching exercises under the Child Support Agency or Centrelink arrangements?

Ms Vivian—Senator, there is specific—

Ms BURKE—I am a member.

Ms Vivian—Sorry.

Ms BURKE—I do not mind other people not knowing that I am not a senator, but people from departments—

Ms Vivian—Sorry, Ms Burke.

Ms BURKE—I am one of those people from the other place.

Ms Vivian—I do apologise.

Ms BURKE—It is okay.

Senator SHERRY—Ms Vivian has to come to Senate estimates so often.

Ms BURKE—I do not go there. That is why I am trying to be nicer than this lot up here—my senatorial colleagues. I do not do that. I would just like to know about the matching.

Ms Vivian—There are quite specific provisions that enable us to provide that information to the relevant agencies. We just do not have the legislation that would allow us to provide the information to the funds without breaching privacy.

Ms BURKE—So there could be a simple change in legislation that would allow you to provide the TFNs to the funds as you do with matching in respect of other agencies who collect moneys from individuals?

Ms Vivian—To enable us to do it there would have to be legislative change.

Ms BURKE—Your current understanding is that the legislation in respect of privacy prohibits you from doing that. Has the ATO actually taken legal advice in respect of that?

Ms Vivian—I do not know whether we have taken legal advice specifically on that issue, but we certainly would have taken legal advice at various times about what we can and cannot provide to people under that banner. That is why we have not been able to provide it to some of the funds. I certainly have looked and it would be a slightly more streamlined manner.

Ms BURKE—I certainly know, through other inquiries, that there have been matching provisions against the death register, because there are a whole lot of people out there who keep their tax file number into the grave. I find that highly entertaining: we actually have a lot more tax file numbers out than we have individuals in Australia. You have done work in other areas of matching?

Ms Vivian—That is true. I think this is much more about passing the tax file number through; it would fall under that issue.

Ms BURKE—Passing it through to the fund, yes. There could be ways and means of getting around it. Is that part of your discussion with the Privacy Commissioner at the moment?

Ms Vivian—We are looking at whether we can do it in a more streamlined manner. We can certainly write to people and say, ‘We’ve got your tax file number, your fund does not appear to be aware of it and you should let them know.’ I would like to do it in a way, as I said, that maximises the number so that we do not necessarily have to rely on people coming back to us.

My aim would be to get permission to say, 'If you don't contact us, we'll provide the number to your fund.'

Senator MURRAY—On the same point, the average Australian has a number of funds. Some funds have been provided with a TFN and others have not. Some people have, for instance, five or six funds—because they have shifted employment—and some of those funds have a TFN and others do not. Have you done any research that establishes that this is not a conscious privacy choice but a failure by the employer or the employee to provide specific information? If you have done that research, shouldn't it be a consideration that privacy should not prevail in circumstances where plainly it was not a consideration?

Ms Vivian—We have not done research on the things you have outlined there. I do not know that I would even call it statistically valid, but we have done some research on why people have not provided their tax file number. Most of them seem surprised; they thought that they had provided it. That seemed to be the issue. They were not aware that their funds—

Senator MURRAY—You are missing my point. An Australian might have a number of funds; in fact, statistically, they do have a number of funds. A TFN might have been provided to some of those funds and not to others. Do you know the instances of that? Is it possible under the present law to make an assumption that, if they have provided their TFN to one fund, privacy has effectively been waived and you are entitled to advise another super fund of that TFN?

Ms Vivian—Sorry, I did not express myself well. I did not miss your point. We have not done that level of research that you are talking about. All I was referring to was—

Senator MURRAY—Would you be able to do it? Is it difficult to do?

Ms Vivian—I think it would be quite difficult to do. On the second part of your question, I do not think the current law would allow us the power to provide a TFN to a fund on the basis that it had already been provided to another fund.

Senator MURRAY—At earlier hearings we have explored this issue. You can tell from the deputy chair's remarks that we are interested in legislative roots by which we could get around an impediment. The assumption is that most people are not concerned about privacy in this area. If 75 per cent of people already give their TFNs—they have to give them to employers anyway—they cannot be concerned. If someone has already provided a TFN for some funds and not for others, where they have a number of funds, surely that should be a legislative area for us to consider. The question for both you and the Treasury is whether, in addition to the option you have outlined—that is, people having to say that they do not want their number provided—there should be placed into the law an assumption that if you have previously provided your TFN to a fund then that automatically allows the tax office to provide the TFN to other funds, because only the tax office can do that sort of linking.

Ms Vivian—Certainly, legislative change like that would assist. I was just thinking about your question about the number of accounts across funds. We have found that people have about 1.4 accounts. That figure is probably based on the lost members register. I do not know if it is correct. So there could be some assistance there.

Senator SHERRY—I just want to be clear on the $1,000 exemption. Is that for contributions in any one financial year, or in any one calendar year? Is it for the application of the new tax penalty, where TFNs are not provided?

Ms Lejins—We will need to check that detail.

Senator SHERRY—I think Mr Forsyth mentioned it.

Mr Forsyth—I believe it is financial year and I believe it is contained in the 5 September statement—what people call the 'gold book'—but I do not have it here.

Senator SHERRY—I think you are right. I am interested in how you would apply that if someone were in two different funds.

Mr Forsyth—It is for each fund, I believe.

Senator SHERRY—It is a $1,000 exemption from this new tax penalty. With the nine per cent SG, you would have to be earning $10,000 a year. So anyone earning less than $10,000 a year, excluding overtime—ordinary time earnings—with nine per cent SG, will not be hit? So you are not going to be hit with this new tax penalty if you earn less than $10,000 a year, but you will be hit if you earn more than that?

Mr Forsyth—If you are a member of the fund as at 30 June 2007.

Senator SHERRY—A lot of people earn more than $10,000 a year. I do not have the stats on me. Would it be eighty per cent of the Australian workforce that earn more than $10,000. Can anyone help me? Does anyone have a broad idea? I am not going to hold you to the nearest percentage. Anyway, a substantial number of Australians—those earning more than $10,000 a year—would be hit with this massive new tax penalty. You must have some idea, Ms Vivian; you work in the ATO. What proportion of people earn more than $10,000 a year?

Ms Vivian—I have figures running through my head but that is not one of them.

Senator SHERRY—It is a lot of people, isn't it? Millions.

Ms Vivian—It is a substantial number of people.

Senator SHERRY—Yes, it is a substantial number of people. I wonder why we did not have a headline in this budget plan that hundreds of thousands—if not a million-plus people—are going to face a tax increase under this new budget plan? All I have been reading about is tax decreases, not tax increases. Can anyone enlighten me as to where in the September or the May budget statement we have the headline about the big new tax increase for hundreds of thousands of Australians—if not a million Australians?

CHAIRMAN—I think you are repeating an earlier question which the officers have already dealt with.

Senator SHERRY—The officers have been remarkably helpful today. I am sure people would want to know about the tax increase so that we can minimise the number who are actually going to pay it. It seems to me it is a pretty serious issue. Ms Vivian, you do see this as a serious issue, don't you?

Ms Vivian—We certainly do see it as a serious issue and that is one of the things we have been looking at in terms of administration: how we can maximise the number of TFNs that get passed through from the employee to the fund.

Senator SHERRY—With the employers, you mentioned the opt-out, opt-in change, which is good. The employer is then legally able to pass the TFN on to the fund so that the employee does not get hit with the tax increase. What is the penalty if they do not pass it on?

Ms Vivian—It can be a maximum of what they call 10 penalty units, which is about $110 per unit. I would also note that, if an employee has failed to provide the number or somehow the tax file number has not ended up with the fund, there is a period of time in which they can provide the tax file number and have the tax refunded or recredited to their account.

Senator SHERRY—What is the period of time?

Ms Vivian—It is the normal amendment period for a fund.

Senator SHERRY—Which is what?

Ms Vivian—Four years.

Senator SHERRY—So they will get a refund of the tax penalty if they provide it within those four years. Will they get interest on their money? I did ask that question at Senate estimates but—

Ms Vivian—You asked the question at estimates and Treasury, I think, have taken that on notice.

Senator SHERRY—Do we know?

Ms Lejins—We need to take the question on notice.

Senator SHERRY—Just going back to the employer, there is no legal impediment to the employer providing the number. They are supposed to provide it, aren't they, legally?

Ms Vivian—Yes, if they have it.

Senator SHERRY—So how would you apply that penalty? Is it per employee? It is up to 10 penalty units?

Ms Vivian—I think it would probably be per breach.

Senator SHERRY—How many employers have you applied a penalty to for the non-provision of TFNs in the last couple of years? Do you have any idea?

Ms Vivian—When I quoted that penalty there, that is one of the existing ones under the current law. Part of the new law is that we are taking over some of that responsibility from APRA.

Senator SHERRY—How many times has APRA applied this penalty, do you know?

Ms Vivian—I am sorry, you would have to ask APRA that question.

Senator SHERRY—I certainly will. So you are going to be embarking on a significant increase in compliance to ensure that employers pass on the TFNs to super funds?

Ms Vivian—Certainly. As I mentioned, though, the areas we would start focusing most of our attention on in implementing this are probably much more up-front. It would be with the software companies in that it is better to get it into the system than come back and issue some compliance action when it has not happened. Secondly—

Senator SHERRY—That sounds a bit wimpy to me. What are you going to do? Here we have hundreds of thousands of Australians who are going to face a new tax because their employer is not providing their tax file number to their super fund as they are supposed to. What are you going to do to the employers who do not provide the TFNs?

Ms Vivian—What I was talking about there was up-front things. We have already started having some very early discussions with some of the clearing houses that provide the funding and some of the payroll providers that the employers use. If, through the way that they do their business, it becomes a natural part of it to provide the tax file number, that will give us the greatest leverage. In terms of the compliance, I suppose the second part is that we would take compliance action against the employers. We are still working out what our compliance strategies might be. But some of the early thinking is that we would start to do some analysis across the member contribution statements, look at where you have large numbers of tax file numbers not coming in from certain employers and use that to guide our risk strategies.

Senator SHERRY—Are you planning an active campaign to go to employers to ensure that you are maximising the number of TFNs flowing to funds under existing and proposed law?

Ms Vivian—Yes.

Senator SHERRY—Okay. How much money are you devoting to this campaign?

Ms Vivian—I do not have a figure for that.

Senator SHERRY—Are you going to give additional resources to this?

Ms Vivian—You were asking me quite specifically about the employers. What I have got is some overall dollars tied up with marketing and education, but that is across both individuals and employers. We do not have a breakdown to the level that you are talking about.

Senator SHERRY—It seems to me that this is a pretty serious issue, though. We are going to get hundreds of thousands of Australians facing a higher tax on their super contributions as a consequence of the budget super announcements—not a lower tax, but a higher tax. I think that will come as a bit of a surprise to some people—particularly the media, who do not follow any of these things particularly well.

Senator MURRAY—You have repeated it enough times, so I am sure—

Senator SHERRY—I hope they have picked it up by now. The media out there should know that there are at least a million Australians who are going to face a higher tax as a consequence of the government's budget plan.

Senator MURRAY—I have got the message anyway.

Senator SHERRY—It is a 31.5 per cent tax increase, media reporters! I hope they have picked it up by now. None of them got it when the budget plan was announced. What level of action or plan or work will be carried out by the ATO inspectors with employers to ensure that the TFNs are passed on?

Ms Vivian—I cannot give you that level of detail because we are just now working out those strategies. What I can assure you of is that we will be looking at both the education level and the compliance level and where we can use resources to check precisely what you are talking about. It is just that we are not at that level of detail that you are talking about.

Senator SHERRY—Given that you work in the ATO, could you give me an example of where a tax penalty is applied to an individual through the non-provision of information by their employer? I cannot think of another example where this sort of principle would apply.

Ms Vivian—I suppose a similar example might be not so much of an employer, but you could look at tax file numbers that need to be provided to the level of when you get interest from your bank account. That would be the similar example I would provide.

Senator SHERRY—So, if the employer fails to provide there, the individual gets the penalty tax?

Ms Vivian—No, it was not from an employer angle there. That is what I was saying. It is more about a similar example that, if the individual fails to supply—

Senator SHERRY—Yes, but that is the onus on the individual. Here, the onus is being put on the employer to provide the TFN, but it is the employee who actually pays the penalty tax.

Ms Vivian—You are saying that the employee pays the penalty tax if the employer does not pass it through?

Senator SHERRY—After the employer should have done so.

Mr Forsyth—But it is the employee who becomes a member of the fund. The employee can supply it themselves and go into the system that way.

Senator SHERRY—In the refund of the money, if an individual—let us say Joe Smith—provides their TFN to the fund two years on, after having paid the new penalty tax, where will the money be rebated to? To their fund, or to them as an individual, in a voucher form?

Ms Vivian—It is probably a matter for the people working through the legislation at the moment, but I think generally the refund would go back to the fund.

Senator SHERRY—Yes, that would have been my assumption. Where an individual has notified the ATO of their TFN and it has gone to the fund and they get their refund, will any action then be taken against the employer for having failed to provide the TFN in the first place?

Ms Vivian—We would certainly be building that into our compliance strategy, to have a look at those employers.

CHAIRMAN—Are there further questions?

Ms BURKE—I want to go to the two questions that I asked the Treasury at the end. Probably the biggest issue of complaint is individuals who leave their employer and discover—or who discover even while they are employed—that their SGC has not been paid. They have been given a statement, they go to their fund, and it is discovered that the statement that their employer has provided does not match the amount in the fund. Various people before us have made comments that the SGC should be paid on a more regular basis. Has the ATO been looking at that? We have come to quarterly, but should it be monthly?

The next question is on the other big issue that comes through the office. If I come to the ATO on behalf of somebody and say, as I literally did on Friday: 'So-and-so has left their employer. They've discovered that they haven't paid any of the moneys,' there is, I would contend, a lack of people in the ATO who are tasked with that job of finding nonpayment and there is the difficulty again around privacy—the individual being advised of where that investigation is going and how it is going—because it is not about their money; it is about the fund's money. It becomes this ridiculous circular route of who should be entitled to know where the money is.

Ms Vivian—On the first question about whether it should be paid quarterly or monthly, I think that is a matter of policy, and I would need to leave Treasury to answer that question. In terms of the issues tied up with the nonpayment of the super guarantee, I do agree that it is an issue. We find that by the time people come to us with the complaint it is often at the time the relationship with the employer has broken down, or the employer may be having some financial issues, so we do find that it is quite difficult often to chase up some of that money.

In terms of the privacy or secrecy issue that you talked about, I would say that it is equally frustrating for our staff that frequently, under the current law, they cannot give the employee information about what we are doing, and yet, from the employee's perspective, they would see it as their money. The government did announce some changes to the secrecy provisions in the last budget. We are hoping that once they are passed we will be able to give more information, without compromising the employer's personal information, about the process and where we are up to, to at least let the employee know what action is being taken, what amount of debt we have started to pursue and where we might be in that.

Ms BURKE—Do you think that there are any legislative changes required beyond that to be able to recoup this money from employers—that there is an impediment in the system that is actually prohibiting the ATO being able to get that money out of the employer?

Ms Vivian—The main impediment that prohibits us is the ability of the employer to pay. Normally, where we can, we will certainly try to put the employer on some form of instalment. The aim is really to try and pursue it to try and maximise the amount of money that we can get back for them.

Ms BURKE—The other frequent complaint is about ascertaining just how much money they should have been given. They have done their calculations, you have done yours and the employer is done. Is there somewhere that an individual can go that says, 'This is what I am actually entitled to'? I know that usually the answer is 'no' because of secrecy.

Ms Vivian—I do have some better news on that front. We are aiming to have a calculator up on the web—they assure me it will be up by the end of May—that will allow an employee to come in and enter the details of what they are earning to work out how much super their employer should be paying. The difficulty in the final bit of the calculation comes when the employer has paid part, so you are getting into issues about nominal interest and potentially some GIC, but I think the calculator will certainly go some way towards helping people understand what their employer should be taking out.

Ms BURKE—My last question—again it might go back to policy and Treasury—is should GEERS also include the ability to recoup lost super payments?

Ms Vivian—That would have to be a matter for Treasury.

Ms BURKE—Thank you. That is all I have.

Senator MURRAY—I have no clear sense of what the level of non-payment of superannuation guarantee is and what the level of underpayment is. My suspicion is that underpayment is a bigger problem than non-payment and that employees would seldom know that they have been underpaid. What mechanisms are there, firstly, to quantify the size of non-payment and underpayment and, secondly, to improve compliance in that area?

Ms Vivian—Some time ago we did a study and we found that there was about 40 per cent non-compliance, with most of it in the micro market. Of that 40 per cent, 50 per cent was partial compliance—in other words, some money had been paid but they got it wrong—and the other 50 per cent of that 40 per cent was total non-compliance. As I mentioned, however, that was some time ago and we are just about to embark on another study to try to better ascertain what the levels of non-compliance might be. That work is underway but I do not expect to have anything from that till towards the end of next year.

Senator MURRAY—Given that, I would suspect, almost every business, micro as well as larger businesses, would either have a tax agent or an accountant, do you think it would be worthwhile, once you have established the scale of the problem, for government to consider an obligation on tax agents or accountants lodging the annual returns to verify that SG has been paid in full—in other words, they would have to do the calculation and verify it? Otherwise, I

cannot see ATO ever getting the numbers to audit effectively and I cannot see you ever getting to a stage where all employees are going to go and check themselves on your web calculator—or check accurately.

Ms Vivian—In terms of the first part, that would be a matter for government—a change of policy. The only comment I would make is that frequently when we get people coming in because of, in a sense, voluntary non-compliance, that is often because the bookkeeper or the agent, when they have been looking at the work, has suggested to the employer that they have not got it right and they need to contact the office.

Senator MURRAY—How long will it take you to do your updated analysis? When are we likely to see the results?

Ms Vivian—Probably not until the second half of next year. Some of the compliance work is being conducted over the next six months, starting from the new year.

Senator MURRAY—I want to ask you briefly about risk. The Treasury's submission indicates that, as at June 2005, there was $172 billion in SMSFs. Where did that $172 billion come from? My view is that SMSFs now represent lower risk because what people have done is transfer sums of money—except where there have been rollovers and other things—that were formerly unregulated and completely discretionary mostly into an area which is subject to prudential regulation. So, even those which you categorise as high risk are in fact lower risk than they used to be, if that makes any sense to you. Are you encouraged by the fact that a large proportion of the population are deliberately putting their funds into a regulated environment to try to secure their retirement income on a better basis? This is a question to both Treasury and the regulator, the ATO. I will tell you why I am asking you this question. If you look at the speech from Michael D'Ascenzo on 1 March 2006, entitled 'Self-managed super funds: the Tax Office perspective' to the National SPAA Conference, you will see that it focused on concerns about risk, and I think those are valid. But I get the sense that it is overstated, because my point is that people going into SMSFs indicates a more cautionary, a more prudential and a more careful view of a large number of Australians about their future. Do you concur with that?

Ms Vivian—I do not know whether I can concur with that. I have not seen any evidence either way. I suppose what was going through my mind when you were saying that is that what I as an administrator tend to hear more are issues about risk, where people have maybe gone into self-managed super funds and not understood what their obligations are as a trustee and what they need to do. I understand that you are coming at it from a broader level than that, but that is the area of risk that I as an administrator tend to hear or focus on more.

Senator MURRAY—That may be true, but what worries me is there is an atmosphere and an attitude in some quarters that SMSFs are a dangerous development because they are less compliant and more risky than the established industry funds—and by 'industry' I do not mean union based; I mean across the whole superannuation industry. Whereas I look at it differently: I say that they are a more prudential form of managing retirement income than the unregulated way in which they were done in the past. That is really the question I am asking you, and I would be glad to hear from you, Mr Legg, if you have a view on that.

Mr Legg—I do not think we can ebb the tide away. We know that the basic premise is: where is the money coming from? What is the counterfactual? But I think it is not an unreasonable hypothesis. It is probably true of some. I think the problem is that SMSFs are probably such a diverse group that it is very hard to say that all are motivated or driven by the same set of factors. When you look at it in aggregate, you probably miss different drivers for different groups within that population, so it is a bit hard to have a general story.

Senator MURRAY—Has either Treasury or the ATO investigated the reasons that people have gone into SMSFs and why the growth is so high?

Mr Legg—In our submission we offered some hypotheses on that.

Senator MURRAY—Yes, but your submission did not spell out any research. You have not done consumer research in this area, have you?

Mr Legg—No.

Senator MURRAY—Has the ATO?

Ms Vivian—No.

Ms Lejins—I think our submission did outline some of the key drivers for the growth and, yes, we did cite other people's studies in that submission. One of the key reasons and the most popular is investor desire for control and flexibility of their retirement savings. That is the main reason being cited in a number of industry research reports.

Senator MURRAY—That implies that they rolled over funds from an arms-length fund into one which they can manage themselves. That would induce you to think it has gone from a less risky situation to, potentially, a more risky situation. The other motive may be that they have taken funds which were loosely managed by the family and put them into a more regulated approach. I am not asking you these questions out of some esoteric interest. If it is from a more risky to a less risky environment then I do not think you want to get overstressed about maximising compliance, regulation and prescription and so on, whereas if it is from a less risky to a more risky environment you might be inclined into that area. I am really asking both the regulator and the policy body whether you have identified the sources of funds and therefore how you should balance the way in which regulation and compliance is approached.

Mr Moore—We have not done any explicit work on that and, as Mr Legg said, it depends on your counterfactual. It is quite possible people are doing both things—they are moving from the APRA regulated sector into self-managed funds and drawing other assets into their self-managed fund at the same time. In the end, as a trustee or group of trustees in a self-managed fund, it depends on whether they understand their obligations under the law and adhere to those. If they do then the safety that the SI(S) Act provides would be there. If they do not then it is not necessarily a given that it would be any safer than it would be outside the system.

Senator MURRAY—Do either of you consider the growth of SMSFs a dangerous or potentially dangerous development?

Mr Legg—I am completely agnostic. I think you have to be aware of it and you have to ask sensible questions, but I do not approach this as some large evil that has to be worried about. The government has a policy which says that people can choose to manage their own superannuation fund and I think that is a reasonable policy. People need to know what they are doing. The level of regulation around that, because they are managing their own funds, will necessarily have less intensity than the level of regulation around an APRA regulated fund. Apart from all the issues of what the counterfactual is, another issue is the one we heard earlier about the level of cash investments. It is possible that some people who put money in their self-managed funds are actually taking less risk. They may be being quite cautious.

Senator MURRAY—Yes, I think so.

Mr Legg—Is that optimising retirement income? Maybe it is not, but then they are taking the risk they want to take and they should be allowed to do that.

Senator MURRAY—I might be being unfair, but I have the sense from some sectors of the industry funds, the public sector funds and the retail funds that SMSFs are slightly illegitimate and should be discouraged. I think that is driven from self-interest. I actually think SMSFs are a good thing and should be encouraged. So I put my prejudices on the table. In Treasury, do you get any submissions trying to encourage you to limit, restrain, restrict or reduce the growth in SMSFs?

Mr Legg—We get submissions from time to time worried about what people are trying to regulate in arbitrage. There are perceptions of people being inappropriately attracted out of the regulated sector into the less regulated sector. We consider all submissions robustly and fairly, but one person’s regulation of arbitrage is another person’s reasonable competition. In this case, we have not felt any need to advise government that there is anything wrong with the basic principle that if you are managing your own superannuation fund in an appropriately regulated environment you should be allowed to do that and take the risks you want to take.

Senator MURRAY—Ms Vivian, with respect to the reading, I take it from the commissioner’s speech that you are really focused on ensuring that SMSFs comply with the law as it is. You have not been advancing to government a desire for greater regulation, have you?

Ms Vivian—No, we advance to governments where we might see something not working with the current law.

Senator MURRAY—Is that driven by a view that there is higher risk than is acceptable in SMSF practices?

Ms Vivian—I think that if we were to see that we may advance that to government. If we were seeing a high risk occurring, we would certainly raise that with Treasury. At the moment, anything we have been raising with Treasury has been more about some issues we may have in regulating under the current law.

Senator MURRAY—But in the public interest sense you have not identified dangers, if I can put it that way, in a significant sense in the sector that require higher levels of regulation?

Ms Vivian—Not from what we have seen at the moment.

CHAIRMAN—As there are no further questions, I thank officers from the tax office and Treasury for your appearance before our committee.

Proceedings suspended from 12.28 pm to 12.59 pm

ADAMS, Mr Mark, Director, Policy and Research, Australian Securities and Investments Commission

DU PRE, Ms Louise, Assistant Director, Super/Life PDS Disclosure, Australian Securities and Investments Commission

RICKARD, Ms Delia, ACT Regional Commissioner and Deputy Executive Director, Consumer Protection and International, Australian Securities and Investments Commission

RODGERS, Mr Malcolm, Acting Commissioner, and Executive Director, Regulation, Australian Securities and Investments Commission

CHAIRMAN—Welcome. The committee has before it your submission, which we have numbered 48. Are there any alterations that you wish to make to the written submission?

Mr Adams—No.

CHAIRMAN—I invite you to make an opening statement, at the conclusion of which I am sure we will have some questions.

Mr Rodgers—We are happy to go straight to questions.

CHAIRMAN—A number of the submissions we have received have pointed to difficulties in providing educational information to fund members and in discussing the internal features of a fund. The concern is that in some circumstances general information is not being provided because of fears of it falling under the personal financial advice regulations. What is your view on this concern?

Mr Rodgers—I think in some cases the concern is exaggerated. It is possible under the current regime that we administer to provide information of a strictly factual kind. But we are well aware that in some circumstances the environment in which information is provided is also an environment in which advice is being sought or recommendations are being made. It is that shift from the mere passage of information to engaging with the particular needs of a particular person that attracts the personal advice regime. We are also aware of the parliamentary secretary's recently released paper canvassing the issue of whether there is a case to be made for clarifying the dividing line between general advice and personal advice.

CHAIRMAN—There has also been concern expressed in submissions that the current regulatory requirements surrounding product disclosure statements and statements of advice are onerous and discourage the provision of cost-effective financial advice. Can you respond to those concerns?

Mr Rodgers—We are on record a number of times suggesting that product disclosure statements are not working as effectively as we would like as consumer communication documents. I think I need to say that there are plenty of examples of good product disclosure

statements—and by good I mean written with the consumer in mind, complying with the law, not being unnecessarily lengthy and focusing on the quality of the communication between product issuer and consumer. But it is also true, and we have said this on a number of occasions, that we too, along with industry and consumers, are concerned that there are too many documents which are too long, too confusing and not doing the job of communicating as well as they might.

CHAIRMAN—What can be done about that?

Mr Rodgers—For our part we have signalled our willingness to engage with the issuers of documents to try to get to a point where we communicate to industry what it is that would improve that as well as about the regime that we administer. There are three purposes served by an ordinary product disclosure statement. One is to actually market a product. One is to comply with the disclosure laws that we administer. The third, and I do not want to be disparaging about this, is to manage the liability of the issuer. In that environment, where there are three potentially conflicting objectives in mind, I think it is not unnatural that it has taken a time to get a degree of comfort on the part of industry and on the part of the regulator about what is required. I am not sure that one can legislate or change the legislative settings anymore than has been done, and I am reasonably confident that, going forward, a good, focused, three-way discussion between the regulator, industry and consumers will lead us towards better disclosure documents.

Ms BURKE—You do not see a need for a regulated, standardised form?

Mr Rodgers—That would be a matter entirely for the government but, historically, there have been some problems with the consumer-effective mandated content or lengths. My own guess and, I think, the assumption on which we are proceeding is that it is better if these things emerge over time. For example, the old prospectus regime had a mandated series of disclosures, and it was not always obvious that complying with those mandates was in the interests of good or accurate communication. I do not think we see a case at this stage for changing that fundamental setting.

Ms BURKE—Do you think that where the industry is going is going to allow the consumer comparability, though? That is one of the biggest issues. You go out and get advice so that you can compare it against other advice. If you cannot compare apples with apples then you do not know what you are comparing.

Mr Rodgers—The objective of comparability is not evenly achieved across the spectrum. In some cases it is quite difficult for that to occur. We really need to be talking about similar product types being offered to consumers whose objectives are similar. Some parts of the mandated regime are working well. The fee disclosure template which, as you know, commenced in full in the middle of last year has gone some way to at least making that part comparable across analogous products. We have looked at other areas. For example, we have asked ourselves whether there is a case for a more standardised disclosure of risk, but that is something you would not want to close down by standardisation because it is very particular to the individual product and the individual issuer.

Similarly, the other leg of what we say is important here is for people to understand in a clear way what they are buying and, given the variety of products on the market, that is difficult to

standardise. It would seem better that we drive disclosure towards clear and effective communication of what people are being offered, how much they are being asked to pay for it and what risks are associated with it than to try and standardise those things in a way that works in fees. It is unclear whether that would work as well outside the fee area.

CHAIRMAN—Is ASIC aware that there is a growing perception, certainly within the retail sector, that it is biased or has a negative view of the retail segment of the industry?

Mr Rodgers—Do you mean by contrast with the wholesale sector?

CHAIRMAN—I mean industry funds and the so-called not-for-profit sector.

Mr Rodgers—Now that I understand that part of the question, could I ask you to repeat the beginning of the question?

CHAIRMAN—Are you aware of the perception that you are biased against or have a negative view of the financial planning industry, for instance, and the associated retail sector?

Mr Rodgers—I am aware that people have, from time to time, expressed some strong views about ASIC here, but I would absolutely deny that we have a bias towards one industry sector or the other. We have, over some time, pointed publicly to problems in the quality of advice. At no stage have we indicated that we have a problem with good advice or those who give good advice. We have consistently said that what worries us is poor-quality advice and that we see ourselves as having an obligation to intervene where we see advice givers departing from the standards in the law.

CHAIRMAN—One instance that has been raised with me is the recent paper on conflicts of interest in which ASIC did not present even one case study that involved a possible industry fund conflict scenario.

Mr Rodgers—We were not segmenting. Many of the examples that we used in that draft—and it was a discussion draft—would apply as much to an industry fund as they would to a public offer fund. So I am not quite sure that I share the perception that that indicates a bias towards industry funds or away from public offer funds.

CHAIRMAN—Are you aware of, certainly, anecdotal evidence and, indeed, reporting at moneymanagement.com.au that indicate that whenever a member opts to move to another superannuation provider, a complaint is being lodged with ASIC about that?

Mr Rodgers—I am not aware of the particular article.

CHAIRMAN—It was on moneymanagement.com.au last week, on 16 November.

Mr Rodgers—As I said, I am not aware of the article. I am happy to take questions about the underlying material.

CHAIRMAN—The concern is that there are some industry funds orchestrating a campaign in that context—that whenever someone swaps from an industry fund to a retail fund, they are lodging a complaint with ASIC.

Mr Rodgers—I am not sure that is at all accurate. We are well aware that there is a dynamic, competitive situation between various parts of the superannuation industry. We are aware that from time to time various sectors of that industry make allegations against the other or against the regulator. I am not aware—and I would expect to be aware—of any systematic pattern of complaints by one or more sectors in that industry following choices. We have had complaints from public offer funds at various stages over the last couple of years. We have had complaints from industry funds or those representing industry funds. We have considered those complaints, wherever they came from, on their merits and dealt with them accordingly.

CHAIRMAN—Are you aware of concern expressed last week by financial planners that ASIC had written to over 300 consumers inviting each of them to make a formal complaint about any aspect of financial advice with which they were unhappy—and had apparently received no response?

Mr Rodgers—To put that in context, I think that is a reference to the fact that after the shadow shopping exercise, which we completed well more than 12 months ago, we wrote to each of the 300 consumers through Roy Morgan, who was doing the research for us. We did not write directly, but we prepared a letter that went to each of the consumers, which effectively said—and I am paraphrasing, you will understand: 'We have now completed this work. Thank you for your participation in it. Here's a copy of the report. If there is anything in the report that causes you any anxiety about the advice you received through the shadow shopping process, you might like to go back to the person who provided that advice and ask them to confirm it. If you do not want to do that but you think there is a problem with it, here is the way to complain to ASIC,' and it gave, I think, the normal email address to write to ASIC at. It was no more and no less than that.

CHAIRMAN—Can you understand why planners might be concerned about that, when they perceive that ASIC is asking the public to create complaints?

Mr Rodgers—In that particular context, where we had publicly released a report saying that while much of the advice we had looked at was good some of it was extremely problematic—we had made that very public—it seemed to us, as the beginning point that had caused people to seek advice through the shadow shopping process, that we needed to make sure that people were aware that not all the advice produced as part of the shadow shopping exercise was good quality advice or to be relied on. That is all we said. This is not part of a general campaign about advice. The shadow shopping exercise was our shadow shopping exercise, albeit carried out by Roy Morgan, in a situation where we saw that some of the advice that had been produced was bad. It had been produced to real consumers who may have relied on it. We felt ourselves obliged to at least draw the attention of those consumers to the possible shortcomings of advice that they may have received—remembering that, because of the arrangements we had for confidentiality, we were not aware of which consumer had received advice from which adviser.

CHAIRMAN—How do you see the ongoing role of commissions, fee for service et cetera as forms of remuneration for financial planners and financial advisers, particularly in relation to providing advice regarding superannuation?

Mr Rodgers—What we have been saying is that we are not arguing that there should or should not be commissions; commissions are a fact of life. We have been saying that if a product manufacturer or an advisory network uses commissions as a form of remuneration then they need to be more cautious in managing the potential conflicts caused by those arrangements and in making sure that they do not undermine the integrity of the advice that is given. It is not an argument for or against commissions; it is simply to say that if you choose a particular business model that has in it a risk that is not inherent in another business model, the law obliges you to make a special effort to make sure that that business model does not cause any damage to the integrity of the advice which the law requires you to provide.

CHAIRMAN—How do you see the role, for want of a better word, of trail commissions in the context of advice?

Mr Rodgers—My answer would be very similar really. Trails are a way of providing remuneration that attaches to advice. I think from time to time historically we have said it is important that disclosure about those trails is made available, and the law now well supports at least some disclosure of that kind. So, again, we are neutral as far as that as a form of remuneration, provided that, as the law requires, it is properly disclosed and that it does not undermine the integrity and quality of the advice given. It may be that in many circumstances that requires additional and careful management by the licensee in a way that would not be necessary were there no commission or no trail commission.

CHAIRMAN—How do you monitor the management of the potential conflicts of interest where an adviser is engaged by an industry fund to provide advice to fund members and may, for instance, be asked by a client or a fund member whether they would be better off in a retail fund than in their industry fund?

Mr Rodgers—In the same way, I think, that we monitor this across the spectrum. Again, just to take your hypothetical example, if an adviser is doing the job that the law envisages, they will effectively do two things—firstly, make sure that they understand the particular needs and circumstances of the individual that they are being asked to provide advice to; and, secondly, provide them with advice that is, at the very least, appropriate to those circumstances, in their best interests and not conflicted by any interests of the client.

It does seem to me that, if the advice were merely at the level of one particular sector of the industry—retail funds—being better or worse than another sector, without evidence, that would not be quality advice. In the end, in the hypothetical circumstances we are talking about, what the consumer wants to do is to make a good decision in their own interests. And the adviser should bring to that a concern for the interests of the consumer and a full knowledge about what might benefit that particular consumer in those circumstances.

I would expect, in the situation we are talking about—and I think we are talking about a particular recommendation for a particular product—that that may or may not be an industry

fund product or a retail product, and the mere fact of it bearing one of those labels should not be determinative of the advice, either way.

Senator BRANDIS—What are the terms of QFS 55—your website guidance as to the distinction between factual information and financial product advice?

Mr Rodgers—I will ask my learned colleague to my left, Mr Adams, to respond, because I think he was closer to the writing of it than I was.

Mr Adams—Thank you, Malcolm. I have that in front of me, and basically—

Senator BRANDIS—Can you read it onto the record? That would be helpful.

Mr Adams—It is a lengthy one.

Senator BRANDIS—Is it? I see. Perhaps you could table it.

Mr Adams—Sure. I am happy to do that.

Senator BRANDIS—And perhaps you might care to speak to it in your own words, Mr Adams.

Mr Adams—Sure. It focuses on basically giving some guidance about what is factual information and what is advice. In doing so, it describes factual information as something that is objectively ascertainable. It then goes on to provide description about that. It contrasts that with advice, as defined in the law, by describing that as something that usually involves a qualitative judgement. So that, in a nutshell, is what it does. It then illustrates that with a number of examples from call centres, seminars, cross-selling and so on. That is it, in brief.

Senator BRANDIS—Are you the draftsman of that, Mr Adams?

Mr Adams—No, it was produced by a number of people. I was certainly involved.

Senator BRANDIS—It is a difficult distinction, though, isn't it? For example, if there were to be a statement which plotted earnings over previous years, that would plainly be empirical and, therefore, factual. But what if there were a document that then extrapolated into future years of projection and said, 'If the investment returns grow at the same average rate as they did over the last five years, these are the returns one would expect over the next five years'? I think, strictly speaking, you would say that is factual too, because it is merely an exercise in calculation. But I suspect most people would think that that would be getting a bit closer to advice, wouldn't they? What would you say about that?

Mr Adams—As this guide says, I think it would depend on the context. So a mathematical calculator of itself may not amount to advice. However, if couched—

Senator BRANDIS—But, to the extent to which it carries with it the implied assurance that there is a level of likelihood of that happening, it might, mightn't it?

Mr Adams—It starts getting the colour of advice.

Senator BRANDIS—Does ASIC have a position on whether the distinction between advice and factual representation should be collapsed into one definition?

Mr Adams—My colleague Malcolm Rodgers referred earlier to the parliamentary secretary's law reform process happening now. It is opening up the debate about the scope of the advice definition.

Senator BRANDIS—That is one of the issues with which we are seized. I know you are an agency but, given the rather broad scope of this inquiry, I do not think I am trespassing too far in asking you if ASIC has an opinion about what the definition should be.

Mr Rodgers—I would not want to be drawn into policy commentary, but I might just say a couple of things. Firstly, it is not clear, to me at least, what merely redrawing the line in a different place between personal and general advice would solve. I acknowledge there are many problems of perception out there. It is not clear that drawing the line in another place would solve those problems. In the regulatory business, there are always arguments about which things sit on which side of the line.

Secondly, while there is a fair bit of anxiety in some parts of the industry about this, our own interventions on advice have not terribly often drawn on that fine distinction because our compliance and occasional enforcement interventions have focused on where, in our view, manifestly bad advice has been given. I think that suggests, at least to us, that the problem that we have been concentrating on—which is the real quality of advice in circumstances where a consumer or a group of consumers is actually going to rely on that advice for making important decisions—have not pushed the envelope as far as the distinction. I agree that quite a lot turns on it and that there is still a fair bit of industry uncertainty, but as a matter of regulatory practice we have not pushed hard on the line issue.

Senator BRANDIS—I understand your point. What you are saying, I take it, is that from a regulator's point of view, if advice is so bad that it comes to your notice, it is scarcely likely to be that bad because it turns on the fine distinction between fact and opinion. It is going to be really bad because it is a shocking opinion.

Mr Rodgers—Just so.

Senator BRANDIS—Thanks.

CHAIRMAN—One of the submissions we have received has suggested that planners or advisers should be separated according to the basis on which they operate. They have suggested that there should be one group that is called franchisees, which basically advise on products from one product provider. Another group should be called agents. They might advise on products from several product providers. Both of those would essentially receive remuneration by way of commissions. The third group would be called independent advisers. They would operate purely on a fee-for-service basis. What is ASIC's view of that proposed separation? Is it feasible? Would it deal with the conflict of interest issues that have been raised?

Mr Rodgers—That suggestion joins those made in the parliamentary secretary's paper last week, which were to create two categories: people who sell products and people who provide advice. I do not think we have a view about the right result there. The government is actually consulting on a slightly different aspect of this in the paper that the parliamentary secretary released last week. The one thing that I can say is that the law already provides that a person may not call themselves independent unless that is in fact true. So we do not need to create a new category of independent adviser, because the law already does that. A person is not entitled to call themselves an independent adviser unless that is actually factually true in every respect. The rest of it is a policy question for the government on which it has already spoken in a slightly different voice.

CHAIRMAN—Have you received any complaints or anecdotal information about dealer groups demanding substantial rebates from fund managers or platform providers in return for having them on their approved list of products?

Mr Rodgers—I am not sure I can tell you whether we have received any complaints. There is a lively debate going on, including in the media, about so-called shelf fees and other remuneration arrangements between product providers and distribution networks. We have certainly had a number of discussions with industry participants about those, and there is presently a debate emerging. It is not at this stage a full regulatory debate, but it is a lively debate in the industry about commercial arrangements between product providers and distribution networks.

CHAIRMAN—With regard to the provision of services to superannuation funds, whether they are retail funds or industry funds, by service providers, whether they are related party service providers or in-house service providers, do you believe there is adequate disclosure of those service provision arrangements and the relationships that exist?

Mr Rodgers—Louise, I ask you to take that question, given your knowledge of disclosures in PDSs or financial services guides as a matter of practice.

Ms Du Pre—Generally, when we have looked at superannuation fund product disclosure statements and annual reports for superannuation funds, we have noticed listed the names of the service providers for that particular superannuation fund. Under previous regulatory arrangements superannuation trustees were effectively required to disclose them anyway. Most seemed to carry over and continue to do that under the product disclosure regime.

CHAIRMAN—As you know, one of the terms of reference that we are examining is the meaning of the concept of not for profit and that all profits go to members. Submissions dispute the claim on the part of some funds that all profits go to members. I suppose, if you were looking at profits in the narrow sense, that might be true. But if you look at profits in the sense of the fund earnings, it is equally true to say that not all of the earnings go to members, because there are expenses incurred by all funds that have to be paid—whether they are commissions, salaries or costs of service providers and the like. Do you think those terms really make any sense in that they are used to try and draw a distinction between different types of funds?

Mr Rodgers—When used in a corporate context, 'not for profit' does not mean that it does not make a profit. It means that profits are not distributable to shareholders, either by way of

dividend or in the event of a winding-up. That is the well-established meaning of the term. I think we are talking about net profits in all of those circumstances, which are the profits after all of the costs of administration. In a sense, it is not inherently misleading for a superannuation trustee entity that does not have external shareholders to whom dividends are payable to describe itself as not for profit in a way that would not be open to an ordinary, say, publicly owned company.

I see nothing inherently misleading about that, nor is that general perception undermined by the fact that, along with the rest of the superannuation industry, payments are made to third-party service providers. I say that in general terms because I think it is perhaps not universally true nor, as I understood your question, inherently misleading if there are related-party entities that are being paid for services. I suspect the truth of that would be whether those arrangements for service provision are arms-length, ordinary or commercial arrangements or whether they were some kind of overpayment by the trustee of the superannuation fund—and on that I cannot help you.

CHAIRMAN—In a sense, is it reasonable to say that all superannuation funds are not for profit in the sense that, once they have paid their expenses, the remaining earnings go into the members' accounts? In drawing a distinction between a for-profit and a not-for-profit fund, what the so-called for-profit fund makes is actually earned out of the fees that are paid to the administrator and the like rather than the actual net of the fund itself, in the same way that the so-called not-for-profit fund operates.

Mr Rodgers—It is true that at the heart of these we have trusts where there is no profit to be made by the trustee in the traditional sense. As I understand the commercial argument here—and I am not adopting it, merely reflecting it—it is an environment where you do not have, in effect, external shareholder expectations about returns from the investment management. As I understand the industry fund argument, it is that that has the potential to deliver lower costs because you are not servicing external shareholders. The answer in that is going to be in the long-term comparative net returns rather than anything inherent in the ownership structure, I think.

CHAIRMAN—The essence as to which might be a better fund is a long-term assessment in terms of the returns provided to members.

Mr Rodgers—I think in the superannuation industry you would have to say that what counts is what happens in the long term rather than the short term, which is perhaps a distinction for some commercially managed funds. But, I am, I repeat, studiously neutral on these issues, as you will appreciate.

Senator SHERRY—Could I just go to another comparable entity—a credit union. Many credit unions are profit for members or not for profit—is that correct?

Mr Rodgers—The majority of credit unions do not offer a shareholding based reward or at least do so only in a quite limited way.

Senator SHERRY—But they are commonly known as profit-for-member or not-for-profit organisations, are they not?

Mr Rodgers—Yes.

Senator SHERRY—Is there any restriction on the ability of credit unions to advertise?

Mr Rodgers—As not for profits, not that I am aware, no—other than the general rule that thou shalt not engage in misleading advertising.

Senator SHERRY—Yes. I have seen numerous advertisements over many years placed by credit unions in both the electronic and the written media. That is generally true, is it not? They can do that if they wish.

Mr Rodgers—Yes.

Senator SHERRY—And presumably that is because they want to retain members and increase members and business—is that correct? That is part of it?

Mr Rodgers—Yes, I presume.

Senator SHERRY—Isn't advertising part of a competitive capitalist environment, to ensure that we have competition and to retain and increase business?

Mr Rodgers—My observation is that advertising is always used to draw attention to the particular merits of what the advertiser has to sell, or the lack of merit in some cases.

Senator SHERRY—Do you know of any segment in the financial services sector, not just superannuation but credit unions, banks, insurance companies and the like, where it is forbidden or restricted to advertise? I cannot think of any.

Mr Rodgers—To advertise?

Senator SHERRY—Yes, to promote themselves.

Mr Rodgers—Not that I am aware of.

CHAIRMAN—Do you regard the current transparency with regard to advertising expenses as being adequate, or should they be disclosed to members?

Mr Rodgers—This is a question about disclosure?

CHAIRMAN—Yes.

Mr Rodgers—They would ordinarily be disclosed, I think, in the accounts of the funds. Did you have in mind disclosure rather than in the formal accounts?

Senator MURRAY—I am sorry to interrupt, Chair. Why do you say they would normally be disclosed in the accounts? Neither the accounting standards nor the method of financial statements reporting in annual reports as a matter of regularity will report on advertising. I have

seen statements and reports that do pick out advertising, but it is not generally a line item that you would expect to see. It is usually subsumed within the broader marketing or communications budgets.

Mr Rodgers—I take that point, Senator. Perhaps I have overstated. I had in mind the marketing line rather than strictly advertising. So perhaps I ought to retract or at least qualify what I said in the light of what Senator Murray has said.

CHAIRMAN—Do you have a view on whether advertising expenditure should be specifically disclosed?

Mr Rodgers—I am not sure that I do.

CHAIRMAN—Are you aware of the recent reports of the Western Australian Government Employees Superannuation Board of staff and members allegedly switching investment options and reportedly engaging in market timing activity at the expense of other fund members?

Mr Rodgers—I am not personally aware of it.

Ms Du Pre—We have been made broadly aware of it.

CHAIRMAN—Have you been monitoring the activity of this or other funds for behaviour that could benefit some members to the disadvantage of others?

Ms Du Pre—We have monitored this activity in relation to regulated superannuation funds. The fund you mentioned is not a regulated superannuation fund under the SI(S) Act and therefore it is not a financial product that we would regulate under the Corporations Act. So we are monitoring broadly for the potential issues that could arise from this but we do not regulate it under the Corporations Act. We would regulate it as a financial product under the ASIC Act if there were any misleading or deceptive disclosure in this area. We monitor it for that only.

CHAIRMAN—That is because it is a state government fund and does not come under your jurisdiction?

Ms Du Pre—That is correct.

CHAIRMAN—So you are not making any detailed inquiries into the issue as a consequence?

Ms Du Pre—If we have any complaints from consumers or anyone who would be affected by this issue, we would take those complaints to the Commonwealth Treasury, which under the heads of government agreement with state Treasury departments would liaise with state Treasury on this issue.

Senator SHERRY—Have you received any complaints to date?

Ms Du Pre—I am not aware of any as yet.

CHAIRMAN—It has been claimed that the adoption of daily unit pricing would prevent, or certainly assist in preventing, activities such as have been revealed with regard to the WA Government Employees Superannuation Board? Do you have a view on whether it would be advantageous to have daily unit pricing?

Ms Du Pre—I am not aware of how often the WA Government Employees Superannuation Board did unit pricing, and we are not fully apprised of all the facts in relation to that particular matter as yet, so I cannot venture an opinion as to what would be better than their current procedures.

CHAIRMAN—With regard to those other funds that you are monitoring, do you look at their unit pricing policies?

Ms Du Pre—As a matter of course we would look at unit pricing policies of those entities we regulate.

CHAIRMAN—With regard to that, have you examined whether or not they practise daily unit pricing?

Ms Du Pre—Yes.

CHAIRMAN—Have you reached any conclusions as to the benefits?

Ms Du Pre—Daily unit pricing—all unit pricing—has particular issues. I guess what we particularly focus on around unit pricing, as well as regularity, is the way costs are structured into it.

CHAIRMAN—Are you aware of the report by Rice Walker Actuaries, *Equitable Distribution of Investment Earnings in Collective Investments*, which they published in June 2005?

Ms Du Pre—I have not read that report myself.

CHAIRMAN—I will quote from that report. They say:

> Our review of the issues relating to the different approaches that can be used to allocate investment earnings indicates that the approach that minimises the inequities occurring is to determine the value of assets daily and express all investment balances in terms of units based on these daily valuations.

In the report summary, they recommend:

- All public offer superannuation funds and all superannuation funds that act as default funds should be required to allocate investment earnings to accumulation accounts using the daily unit pricing approach or an approach that produces comparable results if they wish to accept new members. This requirement should be subject to a transitional period for any existing fund to enable the appropriate changes in administration systems to be made. We believe it would be reasonable to require this change to be implemented on or before 1 July 2007.

Given perhaps that timing difficulty, do you have a view as to the desirability of implementing such a recommendation?

Ms Du Pre—We regulate superannuation funds, for example, that do unit pricing and some that apply a crediting rates policy. It is not our role as a regulator to decide or have a view of which is the most appropriate policy for them in this circumstance, but we do monitor them to see whether or not the process that they do have is equitable for members.

Senator SHERRY—It may not be possible for the witnesses to give me any update, but at the last estimates hearings I asked Mr Lucy about an update on the shadow shopping exercise and the outcomes therein. It was not that long ago that he came to estimates, but he did mention—and I am not quoting his words—that in addition to AMP there were three major funds under ongoing investigation. They are not his exact words but he did say 'three'. Do we have any update on how that investigation is going with respect to those other major superannuation funds?

Mr Rodgers—You are correct; estimates was not very long ago. The short answer is no. I will alert Mr Lucy, who I think is to appear before this committee next week, that he might be well placed if he were able to give you an update.

Senator SHERRY—Estimates is in February next year.

Mr Rodgers—I think PJC is next week.

Senator SHERRY—We have another oversight hearing? That will be four times in three or four months. I am sure Mr Lucy is rubbing his hands in joy at the prospect of another two hearings in the next couple of months.

Ms BURKE—With regard to the shadow shopping exercise that you have undertaken and the fairly good publicity you have had from it, have you seen a change in industry practice following its outcomes and resolutions?

Mr Rodgers—It is hard to say that with any certainty, but there are a couple of things that I think we would be confident about. The consciousness of the industry of the issues we raised, particularly the somewhat more negative issues we raised in our report on shadow shopping, is probably at a very high level. Our interest in it is well known. The issues that flow from being in one of those problem categories are probably well known to industry as well. It is probably a little bit too soon to tell whether there has been a dramatic change, particularly in those areas of conduct that we have most problems with, but I think the environment is certainly better placed for us to be a little bit more confident about that going forward than we might have been 12 months ago.

Ms BURKE—One of the issues coming forward was the notion of switch funds and the lack of information about exit funds. There may have been be a you-beaut fund with all of these bells and whistles, but they did not actually explain what you were leaving. You may have actually been leaving some better things behind. There is this notion of comparator again. Have any steps been taken to ensure that people out there are being provided with exit advice or just education saying that, if you are going to leave a fund, make sure you actually know that what you are going to is actually better than what you have left behind?

Mr Rodgers—As you no doubt know, there were two pieces of work that we did last year. One was specifically on super switching advice and then there was the shadow shopping exercise. That is reflected in some of the publicly available compliance work. The AMP enforceable undertaking deals with that issue. That is one of those examples where I think there is still some industry anxiety about obligation of inquiry. We are sympathetic where it is quite difficult to get details about the possible exit fund, but we have stayed firm that you cannot provide people with good, reliable advice to go from A to B without knowing something about A as well as B.

Ms BURKE—There are complaints from some of the industry sector that they are not 100 per cent sure what you do with the levy that you charge them and that ASIC has poor accounting for what it does and what it is providing. What is your response to the suggestion that the levy arrangements lack accountability?

Mr Rodgers—We are levy funded only to a very small degree compared to our overall budget. I may need to take some of this question on notice because I am not sure how we do account for it. But what I can be confident about is that the amount of resources that we spend on consumer protection in the financial services sector, which is the label given to the levy, is considerably in excess of any resources we get from the levy. A fair chunk of our parliamentary allocation goes to that as well. If you want more, I will probably need to take it on notice and have a look at what we say.

Ms BURKE—I think you have probably answered it, but if there is more information that you want to give us I think we would welcome that. The issue we keep going on about is consumer information and education, and the role ASIC plays in that. It is all well and good to get some things in the *Australian Financial Review*, but not everybody is reading it. As more and more people get their super or are encouraged to switch super or are asked to make an investment choice, what information or process do you have going forward to make sure that we will get fewer bad shadow shopper outcomes and people will actually be informed about the decisions they are making?

Ms Rickard—There is an ongoing process of education. We did a *Super Choices* booklet as part of the whole-of-government effort. We have managed to distribute over 1½ million copies of it now. I can think of one if not two releases we have done just in the last week which have made it into the *Daily Telegraph* and we have done talkback radio on that. So we are constantly aiming to get more finely tuned messages. The one we did the other day was targeted at women who we know have particularly lower super balances.

We have just put a quiz on our website with some teaser questions to get journalists interested and drive home some of the messages. It is something that we work at on an ongoing basis and we will continue to do so. Likewise, we will promote things like our superannuation calculator and encourage people to do their comparisons to work out what their position will be. We will never have a one-hit solution, but it is a permanent part of our education process.

This year we are also focusing on developing resources for schools so that school leavers will at least know some of the basics about super and some of the things they need to understand as they go into the workforce and need to select a fund, or they might want to consolidate funds. We have a long-term program there.

Senator MURRAY—How is consumer research identified as a departmental or budgetary area within ASIC?

Mr Rodgers—As you no doubt know, we do have a Consumer Protection Directorate where there are a number of people with specialist research skills who do some in-house research and also manage some of the external research that we commission. But, again, Delia is probably better placed to deal with detailed questions.

Ms Rickard—We have two full-time researchers who work on consumer research. We have the Consumer Advisory Panel that have a research budget and they commission research each year. We are also doing a major piece of research this year with Roy Morgan, looking at consumer behaviour and investing in how people go about making their decisions, which is probably the largest outsourced consumer research that we have done.

Senator SHERRY—When will that research be available?

Ms Rickard—Not until probably about the middle of next year.

Senator MURRAY—That is what I thought. It is not a separate division; it is a function of the department. I ask you these questions because it seems to me—both from the circumstances of this inquiry and other committees I have been involved in—that from the regulators' and the legislators' perspective, and indeed the Treasury's perspective, we are often in the position of having to guess as to consumer needs or desires simply because there is not broad, wide and extensive research conducted into consumer needs in this area. Do you think that is an accurate statement?

Ms Rickard—There has been a considerable amount of research done in this space in the last couple of years. We made a point of trying to collect every piece of research in the superannuation and consumer needs field that we are aware of. We go through that very thoroughly and put together the responses. I think you can always want more research but, in the superannuation space and with respect to what consumers are looking for and how they are going about decisions, we have quite a good pool of information at the moment.

Senator MURRAY—From whom?

Ms Rickard—Because of super choice, a lot of funds have done research. Research was done behind the government's super choice campaign. We purchased the single source data that is provided by a major research company, which looks at ongoing bases. I think they interview over 50,000 people a year about how they are making decisions. When you take all of the various pieces of research and start putting them together you start to build quite a good picture. I can always think of more questions we would like to be able to answer, but we have quite a good basis of understanding of how people are making their decisions.

Senator MURRAY—What do you spend on research a year? You said you had two employees. Perhaps that is a couple of hundred thousand with on costs. What else do you spend? Would it reach $1 million a year?

Ms Rickard—All told, for consumer research this year—counting staff time—possibly a little bit less than half a million dollars.

Senator MURRAY—My memory is that your total expenditure in the year is over a quarter of a billion dollars—about $260 million? Is that not right?

Mr Rodgers—That is slightly larger than my recollection, but we are in the same ballpark.

Senator MURRAY—Half a million is about 0.2 per cent of that—I think my maths is right. And that makes the point, does is not?

Senator SHERRY—That is where we would like to see super fees—about 0.2 or 0.3.

Senator MURRAY—I am wary of self-interested research, as you would be. It needs to be regarded carefully. If I ask you why self-managed superannuation funds are growing at the rate of, I think, 1,800 a month, I very much doubt you could give me an answer based on consumer research, could you?

Ms Rickard—We could not, but we could point to some research that we have done with focus groups who have gone into self-managed super funds, to research that the Australian Stock Exchange has done recently and to about three other sources. They will start to develop a composite picture for us.

Senator MURRAY—If I asked, with those 1,800 a month that are being created, where the funds were coming from to go into the new super funds, would you be able to tell me that?

Mr Rodgers—No.

Senator MURRAY—If I asked whether the 1,800 a month that are being created were moving from a higher risk to a lower risk situation and whether they were taking unregulated funds into a regulated structure, you would not be able to answer that, would you?

Senator SHERRY—The nods do not appear on the *Hansard*. You have to say yes or no.

Mr Rodgers—I am saying no very quietly.

Senator MURRAY—You have said no to all those questions, and I knew that would be the case. The point I am making, really, is that I am concerned that there is a drive for more and more regulation in the SMSFs area which I do not know is warranted or not. I am concerned that there is a perception of growing risk in that area which I do not know is warranted or not. I am concerned that redesign is occurring with respect to the professional superannuation industry which I am not sure is driven by consumer needs. We are discussing nomenclature. For instance, franchisees versus agents versus fee for service which, to my mind, would be attractive to customers because it is understandable. But the government is responding in a different way and Treasury have told us that that is not consumer research based. Behind all these concerns of mine is a perception that, regardless of what Ms Rickard said about a growing body of research, maybe the regulators who are primarily responsible for superannuation ought to be given the directive by government, or do it themselves, to develop far better research capabilities in the

consumer end. If that was to be a legitimate view, how would the process work? Would ASIC come to its own determination and say, ‘Right, we are going to pick up our budgets and make a far greater resource commitment’? Can you do that on your recognisances or do you have to go the government and say, ‘We want to go in this direction for these reasons and we need an increase in our budget’?

Mr Rodgers—As far as a decision to gear up a research function is concerned, that would be a matter for the commission. If the commission came to the view that that would involve diverting resources from important areas, that may well encourage the commission to go to the government for the funds. The other general point here of course is the point that you make: that there are three regulatory agencies that have a significant involvement in this area. If I were to advise the commission, in moving towards general research particularly on superannuation and consumers, it seems to me that that would be most effectively done as a partnership between the three agencies, which I would hope could begin by amicable negotiation between the three agencies rather than requiring a direction from the government.

Senator MURRAY—I see changes in regulation and compliance as not just having a cost consequence but also needing to have an efficacy attached to them. I hope I am not being unfair to them but my impression from Treasury from a policy perspective and from ATO as a regulator is that their research efforts and consumer understanding in this area is poor and weak. Yours is a bit better, but it is not strong—and we will ask some questions of APRA in due course. Is it best left to you to decide, in conjunction with other regulators, how to lift your understanding so that you can give good policy advice and direction both within the commission and to government, or would it be better for the committee to try and appraise this? If the committee had to appraise this, what should it be recommending—how many resources, how much money, how is it best done? If you would not mind, I ask that you discuss it with some of your senior people and come back to the committee with your view. If consumer understanding were to be improved—on an objective basis, not on a self-interested industry basis—how would that best happen?

Mr Rodgers—I would be happy to take that on notice. It is an interesting question for us as well.

Senator SHERRY—Ms Rickard mentioned a number of specific research documents that have become available to ASIC. At a future hearing I might request more detail. For now, could you give us a list of the sources and subjects of what has been available over the last three years? I suspect that you would have that in a research databank somewhere.

Ms Rickard—We have it and we update it monthly. Some we have received on a confidential basis, so there might be a few missing, but we can certainly provide you—

Senator SHERRY—If it is confidential, at this stage I would not mind getting at least the subject and source. Whether I then pursue it and get an answer would be up to ASIC at a future hearing. But, without breaching confidentiality, I would like to see what is available. Going back to your earlier comments, Mr Rodgers: the ATO is the regulator in the SMSF sector and I think it is unreasonable to expect ASIC to do any significant research in that area. I have pressed this issue with the ATO on many occasions, as part of their general slackness in regulating SMSFs, and I am never afraid to voice that criticism.

Another area of research that particularly interests me is the level of commissions and the way in which they are paid. Does ASIC have any detailed material on the level of commissions paid? I am not talking about averages with respect to superannuation, because averages can be a bit misleading, but the number of people who pay a particular level of commission. Do you have any detailed information on the total ongoing fee that results from that commission plus the other fees and charges that apply?

An area I am particularly interested in, because I want to see the way that competition works, if indeed it works at all, is the level of commission that is dialled down; there might be a one per cent commission applying. How many people will end up with a lower commission, dialled down, and what is the lower commission that results where that occurs?

Also, is there any research on whether in fact we do have a competitive market? Do consumers actually visit more than one planner? Do they go to two, three or four planners, as you would expect in a competitive market, lay down the statements of advice and the pricing, and make a selection? Or do they in the main just go to one planner and stay with that planner? I would be interested in research around those areas.

Mr Rodgers—We might take all of that on notice and come back to you.

Senator SHERRY—I thought you might.

Mr Rodgers—I am not sure that I could answer that.

Senator SHERRY—That is fair enough. When a PDS is issued at the moment and there is a trail commission payment, is there a requirement to provide the equivalent of the trail commission in flat dollar fee terms, so that both have to be offered?

Mr Rodgers—As alternatives?

Senator SHERRY—Yes.

Mr Adams—The product disclosure statement should indicate what the management costs would be, and they then need to break that down to indicate what the adviser fee would be that comes out of, including the trail. That is unlikely to be in dollar figures; it would be a percentage. The statement of advice which is provided to a client upon receiving advice should indicate in dollar terms both the up-front commission and what the ongoing commission would be.

Senator SHERRY—In money terms, flat dollar terms?

Mr Adams—In dollar terms, yes.

Senator SHERRY—Is that issued annually, in a yearly fee, ongoing, in dollar terms?

Mr Adams—It is in the context of the advice that is being provided. If it were advice that says, ‘Contribute X dollars to a particular fund,’ for example, and the trail at the time was 0.1 or

whatever, we would expect the SOA to indicate what that would be on an annual basis going forward, assuming those same figures.

Senator SHERRY—I just want to be clear on this. If the trail going forward was 0.1 on higher levels of contribution, for example—I will take the issue that you have used by way of example—that would be stated as a flat money figure, as an alternative, for the issuing of that particular piece of advice?

Mr Rodgers—It would be stated in dollar terms as a cost, not as an alternative way of buying it, I think.

Senator SHERRY—That is what I am getting at. So at the moment if you went for what is called 'limited advice'—I think it is a poor description, but that is how it is referred to—'higher contribution level', and if it is a trail commission, it is the percentage figure and the dollar figure going forward year on year? Is there no requirement to say, 'This is the fixed money alternative, the flat fee for offering that advice, as distinct from the trail commission or fee trail onwards'?

Mr Rodgers—The obligation is to disclose the fees that will be payable if the advice is accepted. It does not compel you to give the consumer an option about how to pay for that.

Senator SHERRY—Okay. Just one other matter. It seems to me that there are two elements of the trail commission that are often described broadly as 'advice'. One element is advice—the cost of taking the detail and preparing that particular document and the assessment by the planner. But the other element is in fact a reward for service ongoing, a payment for service, for recommending the product. Do you accept that there are two elements, to varying degrees, in a trail commission?

Mr Rodgers—Notionally, yes, because it is possible—and, I think, that is well known—for a consumer to take advice at the beginning of year one and purchase a product as a result of that advice to which a trail commission attaches over many years, without ever actually receiving advice again. It is hard to see in those circumstances—unless that is, as it were, a kind of amortised cost of the up-front advice—whether that actually represents a payment for advice down the track.

CHAIRMAN—Thank you to all of you from ASIC for your assistance this afternoon with our inquiry.

[2.15 pm]

BATEMAN, Mr Dennis, National President, Association of Financial Advisers

KLIPIN, Mr Richard, Chief Executive Officer, Association of Financial Advisers

MURPHY, Mr Michael Francis, Past President, Association of Financial Advisers

REED, Mr Mervin Charles, Member, Association of Financial Advisers

CHAIRMAN—Welcome. Do you have anything to add about the capacity in which you appear?

Mr Murphy—I am a past chairman of the public affairs committee.

CHAIRMAN—The committee has before it your submission, which was numbered 62. Are there any alterations or additions that you wish to make to the written submission?

Mr Klipin—No.

CHAIRMAN—I invite you to make an opening statement, at the closure of which I am sure that we will have some questions.

Mr Klipin—Thank you. I will be making the opening statement and then handing on to my colleagues. Thank you for the opportunity to appear at this hearing. I am with three colleagues. Mr Bateman is from Toowoomba, Mr Murphy is from Adelaide and Mr Reed is from Hobart, and I am from Sydney. Just to give you a bit of insight into our organisation, the Association of Financial Advisers is Australia's oldest adviser association. We are celebrating our 60-year anniversary this year. We are an association of, by and for advisers, with approximately 1,000 members serving approximately one million Australians as clients. Our membership is spread throughout the country, with chapters in all major capital cities. The central focus of the AFA is to help Australians with their financial futures. Our members today provide broad and holistic advice to all Australians, and while our members have a strong heritage in insurance they now provide broad and holistic advice right across the spectrum.

The Association of Financial Advisers has always stood for professionalism in the advice industry. It is about learning and education so that the client gets the best possible outcome. In essence, we think of advice as addressing three main key areas. The first is living too long. The issues that stem from that are about creating wealth, superannuation planning and retirement planning. The second area is dying too soon and the issues that relate to that, such as comprehensive risk management and insurance. The third and final part is becoming sick or ill, and that is part of managing the risks of daily life.

Our members work with their clients in families and in small and large businesses and address all the particular needs of their clients. The industry is needs based and client focused. The role of advice is critical right along the way for a number of reasons. People change. The needs that

we all have as 20-year-olds are very different to the needs that we have at 30, 40, 50, 60 or onwards, and our needs develop and evolve. Our circumstances change as well. Our needs change, and the market and the products also change. The need for advice, initially and on an ongoing basis, is a critical part of the role of our members with their clients. On a broader or macro scale, the assets in superannuation total around $1 trillion and growing. We know that Australians are very underinsured, and that causes issues on a daily basis. We know that we live in a country facing demographic changes with an ageing population and see that the need for advice has never been more important.

However, there are a number of key lessons that we have learnt over many years. The first is that serving the customer well, honestly and diligently is always the most important outcome. The second is that consumers need to make informed decisions, and education is a vital part of that. The third is that advice is key, but it needs to be easy to understand and easy to implement. Finally, the key message that our members have regarding this committee is that advice is a critical part of the process. When we build our house, we use an architect. When we need medical help, we call our doctor. So it should be that when we need to plan our futures and protect our families, we use a financial adviser.

In terms of FSR, the principles have been good for the industry. However, implementation has been somewhat difficult and it has increased the compliance load, overburdened the adviser community and ultimately increased costs for some of the community and the consumer. Member choice is important, but the playing field needs to be level. We also request that this committee considers the plan to increase superannuation contributions from nine per cent to 15 per cent. We further request that this committee considers setting minimum insurance levels in superannuation so that Australia’s families are better protected. To talk about some of the more specific issues in our submission, I would now like to hand over to Mr Dennis Bateman, our national president.

Mr Bateman—Thank you, Richard. With your permission, Senator Chapman, I would like to reiterate some of the issues in our submission. The first point in it was whether uniform capital requirements should apply to trustees. Our members take the view that the primary duty of regulation should be that all providers of superannuation funds that are classed as public offer funds should be required to have the same standards of capital adequacy. This, in our view, means that if a minimum APRA standard for a public offer fund is trustee capital of $5 million as a start-up then this should apply to all funds. The need to have funds provide capital reserves for the management of operational risks should be paramount. No discrimination is to be allowed, as this may cause a future failure and thus undermine public confidence in the regulator and the whole program of retirement savings.

Uniform capital requirements for all public offer funds mean that each is understood to be adequate, has a proper basis for such offer of superannuation savings to the public and can be the basis of proper advice with confidence by financial advisers who are our members. Such minimum capital adequacy is perhaps a starting point. On another point, these funds are recommended to be held in the government’s Future Fund, and the interest capitalised for use in stabilising any prospective fund problem.

Point 2 of our submission discusses whether all trustees should be required to be public companies. Our members are of the view that any trustee of any public offer fund should be a

public company. We take the further view that SMSF trustee provisions are adequate and require no change. This provides exposure to the reporting and transparency requirements of a public company, requires a company to operate within the Corporations Law and ensures that both ASIC and APRA have firm foundations for regulatory action should this become necessary. Our view is that exposure by way of reporting is the best guarantee of compliance and the provision of a total focus on member benefit, not trustee benefit. We therefore recommend that all trustees be public companies.

Point 3 of our submission discusses the relevance of Australian Prudential Regulation Authority standards. We believe that the Australian Prudential Regulation Authority standards are absolutely crucial to the integrity of superannuation funds. This statutory authority sets rules which govern the conduct of these funds and, simply put, the standards are the guarantee that trustees follow the regulator's standards. The AFA asserts that all public offer funds should comply with APRA standards and that those standards should apply by regulation to all public offer funds in order to provide for the safety and security of members' funds. It is this point, the safety and security of members' funds, that is crucial to public confidence. We would recommend to the committee that a high priority for funding allocation in 2007-08 be given to the revision of these standards.

Point 4 is about the role of advice in superannuation. The members of the AFA provide advice each and every day. This is our role in the financial services industry. The role of an adviser in superannuation is not dependent on the size of the members funds account but, more importantly—

CHAIRMAN—Can I interrupt for a minute. I note that you appear to be reading directly from your written submission, which we have and we have read. Could I ask you to raise issues in addition to that or summarise that rather than—

Mr Bateman—Going through the whole lot again.

CHAIRMAN—Yes.

Mr Bateman—That is fine. We will open it for questions now, if you like.

CHAIRMAN—Fine, thanks. The two issues at the outset of your submission are in relation to the uniform capital requirements applying to trustees and the whether trustees should be required to be public companies. The views you put in support of those two propositions seem to be at odds with those of most of the stakeholders in the superannuation industry—certainly those we have heard from in our earlier hearings. Can you enlarge on why you think those two issues are so important from your point of view?

Mr Reed—One of the concerns we have overall is that we have had some fund failures in the last two, three or four years in the financial services industry, but in the past we have had very little problem with superannuation funds. However, the level of superannuation savings is increasing exponentially. We would like the government to pay some more attention to the trustee regulation, the trustee appointment process and the types of people who are trustees. We are not saying there is anything wrong with the present system. We would just like the committee to take the view that trustees should be absolutely above board and that trustee

structures, capital adequacy arrangements and the appointment of trustees of public companies so that they have the Corporations Law to contend with as well as other trust law are in the interests of the people of Australia over the longer term and not necessarily a short-term detriment.

Senator SHERRY—You referred to fund failures—what fund failures?

Mr Reed—We meant that there have been fund failures such as HIH, Westpoint, and all these—

Senator SHERRY—But they are not superannuation funds.

Mr Reed—No, but they are part of the financial services industry and a lot of Australians do not see any difference.

Senator SHERRY—Would you suggest, then, that in the case of Westpoint, where one-third of the moneys were invested through a self-managed super fund, they should have capital adequacy?

Mr Reed—We would argue that the process of product coming onto the market at the present time does not have enough intensive processes separate from the regulator auditing processes under a relatively complex matrix to define what the product is before it gets to the regulator. We also take the view that these products should not be on the market without such processes. That only leads to failures.

Senator SHERRY—But how would you cover self-managed super funds? You refer to public offer funds in respect of capital adequacy. How do you ensure a capital adequacy protection in the case of self-managed super funds a la Westpoint?

Mr Reed—Self-managed super funds have the trustee requirements. Although the trustees and members are generally one and the same persons they are also obliged to seek advice and have a proper plan for the investment of the members' money.

Senator SHERRY—But my question went to capital adequacy application. I actually asked Treasury earlier to provide us with evidence of failure, and details thereof, of what I would call mainstream superannuation funds, as distinct from self-managed super funds, of which there are plenty of examples, unfortunately. I am just interested as to why you would argue capital adequacy given the apparent lack of failure by mainstream super funds. The current prudential regulation seems to work.

Mr Bateman—It was our view that there was no need to make any changes to the self-managed funds.

Senator SHERRY—I know, but that is the point that I am getting at. With mainstream super funds—industry, retail, corporate—you are arguing for some level of capital adequacy increase, an area where there is no identified systemic risk or failure. With self-managed super funds, where there have been a number of cases of risk and failure, you are not arguing for capital adequacy. Haven't you got it round the wrong way?

Mr Bateman—The trustees, members and beneficiaries are all one and the same people, so they are not dealing with external public moneys. There is a difference there.

Senator SHERRY—But why do you argue for increased capital adequacy in the case of mainstream capital superannuation funds in the absence of any evidence that there is failure?

Mr Reed—What we are arguing for is a future position. We are not making a judgement as to whether there are any failures or possible failures or risk factors at the present time. What we are saying to the committee is that we believe that Australians should save 15 per cent of their income over their life to have an adequate retirement without the public purse being required. What we are saying is that to do so the confidence in the retirement savings system—superannuation—must be absolute. One fund failure in Australia will fundamentally set back the cause of long-term retirement planning for a lot of Australians.

To answer your question on self-managed super funds, we also express some concerns, both to the regulator and in other forums, at the lack of advice on some of these funds. There have been, as you said, documented cases of fund failure and very many thousands of cases documented by the ATO of noncompliance. We also believe that people should think long and hard about whether they invest their funds in self-managed super funds. That is all we are saying.

CHAIRMAN—In relation to the fit and proper person test for trustees, do you believe that the bar needs to be raised there?

Mr Reed—We think that it would be in the funds' interests or the members' interests that people who are going to be trustees of super funds or managed investment funds should go through and do the normal testing that is required of public officers, especially police checks, character checks and fiduciary checks to ensure that a proper person is appointed.

Senator SHERRY—But that happens under the new safety provision—that is what APRA have just put them all through. That already happens. APRA have just put all the trustees through this—other than SMSFs—as part of the licensing process, haven't they?

CHAIRMAN—Do you think that that licensing process is adequate?

Mr Reed—Yes, we do. But these levels have been got to only in the last 18 months.

CHAIRMAN—You mentioned that the history of the organisation is principally in insurance. In today's market, could you perhaps clarify for the committee the role of your organisation and the role of your members as against the role of the Financial Planning Association and their members? Is there a significant difference? Are there nuances of difference?

Mr Murphy—It would be fair to say that we probably do not have the large licensee membership that the FPA probably has. We tend to be more an adviser and a smaller licensee organisation. So there is not a lot of conflict, that they would have at some levels, in our association because ours is one that has really been based on face-to-face advice and advisers.

Mr Klipin—If I can add to that, it would also be fair to say that the market for advice has got increasingly sophisticated and therefore advisers have increasingly specialised in certain areas.

There is the Self-Managed Super Fund Professionals Association, for example. The AFA has come from a heritage of insurance, and is now broadly based. The FPA came out of the investment planning community and has had tremendous growth in the last 10 to 15 years. What we are starting to see is that a whole plethora of adviser related associations are basically growing to meet particular requirements and particular needs.

CHAIRMAN—Would you like to enlarge on the role of advice, particularly as it is relevant to superannuation? Also in the context of that, one issue that has been raised is the conflict of interest in relation to advice on the basis of commission versus fee-for-service, trail commissions et cetera. Could you give us an overview from your perspective of how the advice system operates and how the remuneration system in relation to advice operates, as against product distribution and the like.

Mr Murphy—As far as our association is concerned, we have always maintained that there should be choice—whether it be on remuneration or whether it be on product and whatever goes with it. There also needs to be a focus on a holistic approach. I think in the earlier years people have to be very mindful of their liability, particularly regarding insurance. As Mr Klipin said in his opening remarks, we really have to build foundations—his analogy was that if you are building a building then you should go and see an architect. I think you have to look at the whole picture, and at various stages in people's lives there have to be different focuses on it.

The remuneration will vary. The initial focus is on insurance products, vis-a-vis funds under management, and as they progress through the increased assets in their superannuation fund the focus will go over to the best use of those assets. So it is looking at the whole picture. The remuneration approach will always be one of, 'Here is our view of the advice you should take; how you pay for it is really up to you.' As long as we maintain the disclosure regime that has recently been put in place, I do not think there is really an issue of conflict of interest.

CHAIRMAN—Particular concern has been expressed about trail commissions. Could you perhaps explain the role and the justification for trail commissions?

Mr Bateman—It is in the same context as the initial set-up costs and that type of thing. A trail commission is another form of remuneration. Whether the client wishes to pay for it by a monthly debit or whether they wish to pay for it out of their investment, that is their choice. I think if we give clients the choice of how they want to pay for the advice that they receive then that is a lot easier than legislating for it.

CHAIRMAN—But if they paid a commission at the outset, why is this trail commission also justified?

Mr Murphy—There is an ongoing need for advice. Under the regulations we are supposed to review clients every year. Personally, it is not my favourite thing because I think superannuation particularly is a long-term investment. However, within that environment, as I said, the circumstances will change. There is a need for insurances earlier on and there is a need for, I suppose, a specific investment profile if you look at the requirements of the legislation. But I hold with a view that is really trying to keep the clients focused on their end goal and maintaining a source of information and education all the way through.

Senator SHERRY—Are you suggesting that 10 million Australians should be paying a trail commission to get advice every year on their super? Is that where you think the system should be?

Mr Murphy—We have a requirement now, under FSR, to do an annual review. I do not completely concur with that.

Senator SHERRY—In what way do you not concur with it?

Mr Murphy—I do not think, once you have set a strategy for a client, you should be taking a one-year view to change that strategy, on the investment side of it.

Senator SHERRY—Why do you come to that conclusion, say, on the investment side?

Mr Murphy—Because I think you have to look long term. It is a long-term investment.

Senator SHERRY—I happen to agree with you. I do not know why you would be going back and forth getting investment advice every year.

Mr Murphy—Neither do I, but that is a requirement of the regulations. As I said, I do not really concur with that. However, there needs to be continual contact, because people are influenced. I think probably the biggest thing we have as a practice is to continue to keep clients focused on where they started and where they need to be going, because there are lots of distractions in terms of where they should be putting their money.

Mr Klipin—There is a broader issue as well, and that is that, whilst here we are talking about superannuation, when advisers deal with their clients they talk about all of the client’s affairs and it is a holistic look. A client relationship is not just about discussing what is happening in their employer superannuation fund; it is about what is happening with their wealth accumulation program, their risk management program and so on.

Senator SHERRY—That causes me enormous concern. The concern it causes me in the case of a trail commission is that effectively we have the superannuation system paying for holistic advice, which is not the purpose of superannuation. That would be my argument. The degree to which FSR forces you to do that, I have a very great sympathy and understanding, because I think FSR does force overservicing to some extent.

Mr Klipin—When I see my financial adviser I am going there to talk about my entire financial affairs. Rolled into that is part of the superannuation issue—absolutely. Our members and associations similarly run practices where they are looking to deal with clients and their families over the course of their lifetimes and provide holistic advice through that process.

Senator SHERRY—But the key issue to me is whether that should be paid for against superannuation, which is a retirement benefit. The money is there for retirement—it is not for other things. Sure, we would all love financial advice about our budgets and everything else, but is that a legitimate cost of a superannuation retirement system?

Mr Reed—There is perhaps another way of looking at this. If the financial adviser over a period of a lifetime is going to add some value to the client—and, of course, there will be some remuneration from the client to the adviser—then that is a positive for the client. I may see a client and provide overview advice on the set-up of the super; put in place a proper will and legal structures for the family; make sure that the insurances are balanced, that they can afford them and that they are not overdone or underdone, but it is the right process. Each year, as the risks either increase, with additional mortgages, or decrease, through paying off debt, we do the review required by the regulator of the client's affairs. For that I will receive a fee of some sort. Whether the client wishes to pay me on the basis of fee-for-service or by way of a service or trail commission is really the client's choice.

Senator SHERRY—Yes, but should it be paid for against compulsory superannuation? I think there is a legitimate argument about level of contribution to superannuation and level of death and disability insurance within superannuation. I think they are legitimate advices related to superannuation. But is other stuff a legitimate part of superannuation?

Mr Reed—You are talking specifically about superannuation guarantee contributions?

Senator SHERRY—Yes, I am.

Mr Reed—Superannuation guarantee contributions, we would argue, should be 15 per cent. You would probably agree with us. We would also argue that, if we maximise the investment returns on superannuation guarantee contributions, if we know the client well enough to provide initially a five- to seven-year investment horizon, if we know the client well enough to make sure that those investments meet their investment sensitivity and do the best possible job we can do for that client then, yes, we believe we should be paid by that client even if it involves superannuation guarantee funds.

Senator MURRAY—Just so that I understand the discourse between the two of you, is it your comment, Senator Sherry, that the commission paid by the superannuation product provider or the trailing commission is effectively paying for the entire suite of advice?

Senator SHERRY—Yes—for the whole package. I have no argument about the cost being charged against compulsory superannuation—or voluntary superannuation, for that matter—in respect of level of contribution and level of death and disability insurance. I have no argument about those types of advice. But, frankly, I have a very significant concern with some industry practice where the whole suite of your entire financial management is debited against the cost of superannuation, whether it is fee or commission.

Mr Bateman—It might not be. It could well be that they have personal investments outside of superannuation which shares part of the cost as well. But I think it comes back to choice. The client can choose to pay us by way of a cheque once a year or whatever.

Senator SHERRY—Yes, of course, and they do not do that, because it is much easier to debit a fee over time against a compulsory contribution paid by the employer, which is the majority in our system. We are going to disagree on this and I have cut across the chair. I just state my extreme concern at this broadening of advice and the cost being debited against super. I think you are heading into very dangerous territory. If our system ends up with 10 million people

paying trail commissions of 0.3, 0.5 or one per cent, you will discredit the system. We will end up with the ultimate choice argument—that super should not be compulsory. Why shouldn't consumers have choice? If they are going to get ripped off with commissions, as they are in some cases, why shouldn't they have the ability to choose not to be involved in compulsory super? That is going to be the logical outcome of it all.

Mr Murphy—With respect, this is one of the problems. It was imposed by legislation and therefore the government has to have a stake in the argument, I agree. But also the advice industry must be able to seek adequate remuneration.

Senator SHERRY—It is the form of the remuneration.

Mr Murphy—I accept that. I think it is a matter of how much—there is no doubt about that. But I think there would be no question of the fact that people who get advice generally have far better outcomes than people who do not get advice, taking into account the fees that they pay for that advice.

Senator MURRAY—I need a bit more information so I can understand this. How common is it that a client coming to you is getting estate planning, which is your will and the way it is structured, planning for the future with respect to the family, current investment planning and superannuation planning as a whole suite of activity? How common is it that that is only paid for through superannuation commissions or trailing commissions?

Mr Bateman—It would not be very common at all. That would be an isolated case. It is generally spread across—

Senator MURRAY—So how would you structure the fee charged when a person comes to you and says, 'I want you to do the whole picture'? How does it actually work?

Mr Murphy—I think what has happened with the superannuation guarantee is a good thing. It has really opened the door for people to come and get advice, because they do then have an asset to deal with.

Senator MURRAY—But how do you charge them at present?

Mr Murphy—When they come to us we go through the process as required under the regulations, which is filling out a statement with an understanding of their current position.

Senator MURRAY—How are you paid?

Mr Murphy—As far as my practice is concerned, I am paid on commission. I would say it would be a general rule that the majority of advice would be paid for by commission.

Senator MURRAY—So where you provide a client with non-superannuation advice, it is common for it, in your experience, to be paid from superannuation commissions?

Mr Murphy—Yes.

Senator SHERRY—I do have sympathy for you—we are probably in raging agreement—when I look FSR and the outcomes. Let me use a medical analogy. If you go to a doctor and you want specific advice about a particular ailment, FSR means you have to receive a whole-of-life check with every conceivable possible ailment that could occur. To some extent FSR forces you to engage in research that you would not otherwise do.

Mr Murphy—I have in fact been in that situation from a medical perspective and had they not conducted that full medical research I would not be here today. It is a very fine line as to when you should get a far better check-up than just going for specific advice.

Senator SHERRY—But you asked for it.

Mr Murphy—As an insurance salesman or a financial adviser—

Senator SHERRY—But the problem is that FSR requires it; FSR forces it to some extent.

Mr Murphy—I agree. Again, that is an imposition of government that has caused an enormous increase in the workload and the cost of our practices. As I said before in previous hearings, the cost of training employees within our industry has absolutely gone through the roof. As I said at my closing address at our last conference, the sad part about our industry now is that there are people being far better remunerated for education and compliance than those giving advice. That is a sad situation as a result of FSR.

Mr Reed—Perhaps we could add to Senator Murray's question. One of issues facing financial advisers is that, if you do not go through the know-your-client investigation that Senator Sherry has indicated is required under FSR and if you do not provide a wide and full spectrum advice to your client, you are liable. You are absolutely, 100 per cent, open to any sort of claim whatsoever. On the other side, depending on the client and whether it is a substantial client, the cost of the advice may be up front as a fee-for-service payment by cheque, it may be a considered rebate of the trail commission on the investment placements, it may be a continuing small trail commission on the insurance investments and it may be a small or no trail commission on superannuation.

Senator MURRAY—I am aware of the options by which you could itemise a fee, but my question was: what is the common way of doing it? Mr Murphy's answer was that the common way of doing it is to attach the whole suite of appraisal as a funded item through the superannuation.

Mr Reed—That depends entirely on the financial advising practice itself.

Senator MURRAY—Then you need to tell the committee, as representatives of 1,000 financial advisers, what is common. Is it common to itemise and separate the items so that you are paying a fee for service for non-superannuation advice whether it is being done through commission or not? Mr Murphy's answer was that it is common for it to be in the superannuation field.

Mr Reed—To correct that: it is not wrapped up in the superannuation contribution. Individual products are part of the whole financial plan. Commission is generally the way in which the remuneration is paid.

Senator MURRAY—So the insurance product will pay for the insurance advice et cetera?

Mr Murphy—Yes.

Mr Klipin—I think the variation of answers simply reflects that, with about 17,000 advisers around Australia, practices tend to run on different models. Whilst in downtown Adelaide you might have model A at the end of the table, in downtown Hobart you might have a different variation. That is really reflective of the client base that they deal with, the kinds of services that they provide and where they are in their growth phase as a business.

Senator MURRAY—But I have pursued this because you can see by the strength of Senator Sherry's reaction that, if it is common for all financial advice to be principally funded from superannuation commissions, policymakers, legislators and the community are entitled to get concerned. However, if it is occasional rather than frequent—in other words, if estate planning is paid for separately and insurance is paid for separately—then there is not the same issue. I still have not got a feeling from the four of you as to what the general practice is.

Mr Klipin—To answer the question directly: FSR has unbundled the advice part from the implementation of products part. You would generally find that a client and an adviser will meet and do fact-finds and out of that will come a statement of advice. People often charge a fee for the statement of advice. It could be as low as $300 and it could be as high as $5,000. There is a general range depending on complexity. The second part is that, if people are going to go ahead and implement that advice—and the implementation might be an allocated pension, a superannuation fund or comprehensive insurance—they might arbitrage or rebate back some of the commission or some of the fee they would have taken. Again, that is to do with disclosure and choice about how the client wants to engage with the adviser. The relationship that they then have on an ongoing basis, which often people call ongoing care or servicing, is the way that client and adviser then tend to work and that may be a percentage of assets, to use Senator Sherry's analogy, of 0.3, 0.5 or up to one per cent. It may be strictly on the trails that come out of the insurance product; it may be a cheque written on an annual basis for the time it has taken. Again, there are variations in models simply because of the variation, but that hopefully gives you a better sense—

Senator MURRAY—That is better, and your answer implies that the client is always advised of the way in which the fee has been disaggregated.

Mr Bateman—That is correct.

Mr Klipin—The driver of all of this practice in action is disclosure. It has to be disclosed and we heard earlier today and at previous hearings that it is law.

Senator SHERRY—Disclosure drives competition in itself.

Mr Bateman—Absolutely.

Mr Klipin—That is right.

Senator SHERRY—Perhaps you could take this on notice, because I would not expect you to have the figures here. In terms of the people you represent, what is the range of commission charged, the actual number of people who negotiate a lower commission—dial down—and the number of people who visit a number of financial planners, where we have competition in full force, playing you off against each other, with people going not just to one planner but to four or five? Frankly, I get the anecdotal view that it does not happen very much at all. And on dial down I get the anecdotal response that very little of it goes on, because the consumer is frankly powerless; otherwise, why would they come to you?

Mr Murphy—In answer to that: the consumer is not powerless. We are often faced with a number of financial plans that are presented to us, now that they have access to a bank, which they see as a service provider to themselves, and they have access often through their employer's association with a superannuation fund and through their accountant, which is now another major source of referral for advice. I would not say it is a major source of advice.

Senator SHERRY—It should not be! Under FSR, it should not be.

Mr Murphy—I said a referral for advice, Senator Sherry.

Senator SHERRY—I am doubtful about it, but anyway!

Mr Murphy—I would like you to force that one too. I would like your reaction to that to be the same as your reaction to trail commissions.

Senator SHERRY—I have a very strong reaction to that one too.

Mr Murphy—You have been practising that for a very long time, which is why you are so very strong about it. But, no, there is sufficient choice. That is the most important thing about FSRA. Choice of payment is very important too, because a client will come and ask, now, 'How do you get paid?' and the answer can be, quite honestly, 'By fee or by commission.'

Senator SHERRY—What I would like is a survey, some data, back from your members along the lines of—I have asked the regulator.

Mr Murphy—I thought Senator Murray was asking that question about surveys.

Senator SHERRY—He was, and I am asking too. I know we could talk about the commission issue all day, but—

Senator MURRAY—Just to clarify this issue: you are a small outfit of 1,000 members—can you afford to do it? Are you able to do the sort of thing you have been asked to do by Senator Sherry?

Mr Murphy—Mr Klipin can answer that one, but I think we can get a fairly good—in fact, we did a survey last year. When Richard came on board as CEO, he did a survey on a number of those issues. I think we can get some answers.

Mr Bateman—We could put it in as a mail-out, a loose leaf in the magazine. I might just respond on—

Senator SHERRY—While we are on these accountants—given that I do not think any of you are accountants, or you might have had it coming—is it your view that, in terms of FSR, the exemption given to accountants should not exist, that if we have regulation it should be regulation for all?

Mr Murphy—Yes.

Senator SHERRY—Not just for planners but for accountants as well?

Mr Murphy—It is a fine line. That is a difficulty. Senator Murray brings up the issue of self-managed super funds a lot in dialogue. It is a real problem; there is no doubt about it. The accountant has the chequebook in the commercial relationship with most clients in small business, who are a major part of our client base, so therefore they have influence. Two things have happened. With FSR, that influence now has not extended to the fact that they can give advice, which they did previously—I am not saying that it was good advice—so you do now have a great number of self-managed superannuation funds that have been established, and advice has not been given regarding the investment. That is a problem; there is no doubt about that. But I agree with you that it should be a level playing field. As Richard said in the opening address, everybody should be subjected to the same licensing requirements and therefore the ability or inability to give advice on financial products.

CHAIRMAN—While we are on the issue of disclosure, I note under that under 'Any other relevant matters' you also refer to disclosure in relation to:

... payments between the product supplier of superannuation and the holder of an AFSL—

the licence—

as a dealer in securities, to clients or members of the fund.

I do not know whether you were here when I asked ASIC whether they had had any complaints from fund managers about requirements to pay dealer groups rebates in return for having their particular products listed in the dealer group. I guess that is addressed by your issue there of disclosure.

Senator SHERRY—Do you think it should be allowed at all?

Mr Reed—Mr Chairman, one of our problems—and the reason we made the point to the committee—is that we believe it should be disclosed.

Senator SHERRY—But why should dealer groups have to pay what I think are some pretty outrageous fees that seem to be emerging just to get themselves on the list?

CHAIRMAN—They are fund managers, not dealer groups.

Senator SHERRY—The fund managers, sorry.

Mr Murphy—Mr Klipin is probably in a good position to answer this question because he came to our association from an industry background.

Mr Klipin—Our view is simple. It is around transparency, openness and disclosing to clients. In a sense it is a commercial piece of work and as long as people know what is going on and clients are fully informed about it then we are comfortable with that.

Senator SHERRY—Even under the current disclosure law, which no-one can understand?

Mr Klipin—That is the point; it needs to be meaningful.

Senator SHERRY—I just suggest that if the industry is going to head down this track it is going to get discredited by this sort of behaviour. Most people, frankly, do not know what it means—certainly under the current disclosure.

Mr Klipin—Yes.

Mr Reed—There is no current disclosure in SOAs of overrides.

CHAIRMAN—At the moment the only disclosure is the direct remuneration being received by the advisor?

Mr Reed—That is right.

CHAIRMAN—You are saying that the disclosure should go back up the line to remuneration that is being paid or received by the groups up the line?

Mr Murphy—Correct.

Mr Reed—Mr Chairman, if you were receiving advice would you not want to know this?

CHAIRMAN—I certainly would, but I might be regarded as pedantic.

Mr Reed—I am sure that the whole of the committee would want to know what they are paying for. That is ultimately what they are doing.

Senator SHERRY—But let us say it was disclosed simply and people were able to read it and find it—we will put that set of issues aside under FSR—do you think they would understand the implications of it?

Mr Reed—When it was set out in dollars on an annualised basis with all the other costs and fees that we are required to provide in a statement of advice, quite probably yes.

Mr Murphy—I can add that now there is a focus on fees and charges. We are very often being asked to explain annual statements. The disclosure at our level is always on the annual

statement but, as you rightly say, there are other fees being charged. The chairman asked the question—probably our association is not the one at the coalface in terms of the additional fees being paid because we are mainly made up of advisers who are probably not aware in some cases of the background.

Senator SHERRY—Aren't these listing fees a form of blackmail—if you do not pay the money, you do not get the access? That is effectively what they are doing, isn't it?

Mr Reed—Senator Sherry, perhaps you should pose these questions to the regulator, but you would also pose the question and say, 'You have to make the commercial decision; you are a fund manager.'

Mr Bateman—I can comment on something that Senator Sherry would like to know regarding his understanding that in most cases commissions or fees may not be dialled down. In our practice that is a commonality.

Senator SHERRY—That is good to hear. I will be out there promoting your practice. What is its name? Seriously, I would be interested in seeing to what extent and level it occurs, in terms of your members.

Mr Bateman—Would you like to look at our website? It is all disclosed.

Senator SHERRY—Yes, send it on to me. I will be happy to look at it. I would hope that you are typical of the entire industry.

Mr Bateman—I cannot say that.

Senator SHERRY—But you can stick up for yourself here, and that is appreciated.

Mr Bateman—I did not want that impression to remain. There are a broad range of fees and there are discounts. Certainly, if somebody has a million dollars they are not going to pay rack rate.

Senator SHERRY—On the issue of commissions, do any of you have any observations to make about the outcomes of the shadow shopping exercise? You may or may not want to touch on the AMP enforceable undertaking, but on the outcomes of shadow shopping. One in five planners was clearly influenced by commission in terms of where the superannuation savings went.

Mr Klipin—We are on the record through a press release on 11 April basically saying that shadow shopper 3 reflects the industry state of play. In a sense, what the shadow shopper process does is hold up a mirror to the industry and we have to be able to look at it and see what we can learn from it. We have used the analogies previously around the medical industry and architects. It has to be right all the time because that is the standard we all have to get to so that the community in general has confidence in what we are doing. Whilst there have been increases and better outcomes over the last three years, we still have a way to go. We do not resile from the fact that the issue around advice is critical and the confidence of the community is equally critical—and shadow shopper 3 told us the way it was at that time.

Senator SHERRY—Architects and lawyers charge fees. Why can't you charge flat fees? Some of them are pretty expensive, I have to say.

Mr Reed—We do.

Senator SHERRY—Do professional organisations charge commissions?

Mr Reed—I think some lawyers do charge commissions.

Senator SHERRY—How does a lawyer charge a commission?

Mr Reed—A share of the return.

Mr Bateman—On conveyancing, there is usually—

CHAIRMAN—A success fee.

Senator SHERRY—It is still a fee. Maybe planners should pay a success fee—a performance fee. You outdo the index in terms of the rate of return.

Mr Murphy—A lot of discussion has gone on in New South Wales regarding lawyers' fees, headed by Chief Justice Spigelman. It has proven to them that it is not the way they should be charging—and there has been a lot of publicity about that. But they do charge commissions; they will charge on a job basis. Senator Brandis is from that profession—and, yes, they do charge a fee for service.

Senator SHERRY—They charge commissions, do they? What do you think of this, Senator Brandis?

Senator BRANDIS—Obviously, solicitors charge for certain services—for example, they charge conveyancing fees on a basis that varies with the value of the property. But, ordinarily, in litigation, which I think most people are thinking about when they talk about success fees, I do not know the position of solicitors but I know that it is not ethically permissible for barristers to charge on a commission basis. However, if barristers, and I imagine solicitors too, take a case on a speculative basis—that is, they do not charge a fee unless they win—they are entitled to charge an uplift on their ordinary fee. It is relatively modest; I think it is not more than 50 per cent of what they would otherwise have charged. My point is that cannot bear any relationship to the size of the judgement.

Mr Klipin—There is a great deal of debate and focus around the industry on fees versus commission and models and practices. The advice industry is trying to focus on the value of advice—the value of what our members do on a day-to-day basis. It makes sense that it needs to be cost-effective, affordable and value for money, but it needs to be very clear what the outcomes are. What would have been the cost if the client did not go into an asset class that matched the risk profile? What would have been the cost if they had taken out comprehensive insurance cover and got diagnosed with an illness or there was an accidental death and, therefore, their families were protected as a result of that? When we have this discussion and debate within the industry there is a lot of discussion around this issue of the value of advice.

What is the value of what people are doing and does the cost fairly reflect that? Clearly, disclosure is critical and people need to know what they are getting. But we need to broaden the discussion to consider what people get out of it. Within the association and more broadly in the industry there are awards that focus on the value of advice. Recently, at our national conference, we awarded our young adviser of the year and our adviser of the year. A lot of that was around the broadness and holistic nature of their advice, their community contribution, their areas of speciality, their background and so on. I think that is an important thing to add to this discussion.

Senator SHERRY—On a totally different issue: I was a little puzzled when you said that the Westpoint scandal would lead to an increase in self-managed super fund activity given that, where Westpoint was delivered through super, it was self-managed super funds. It would seem to me to have the reverse effect: people would be more scared of going into an SMSF given what happened with Westpoint.

Mr Bateman—I think it is to do with the uncertainty in the industry, especially if they were relying on financial advice to get that outcome. People become sceptical of the public offers if there are losses. Therefore that could increase the number of people wanting to do their own thing, because the self-managed fund is a do-it-yourself super.

Senator SHERRY—I understand that, but it seems to me that the scandals in the industry—and Westpoint is the worst in a long time—are through the self-managed super fund sector, not through other superannuation type entities—corporate, industry or retail.

Mr Bateman—There are definitely those people who had a self-managed fund who were advised to go in there by their superannuation adviser. They would be most unhappy. But for those people who had other investments, they could become sceptical about the financial services industry.

Senator SHERRY—I accept the point about the broader financial services industry.

Mr Bateman—Therefore, that was the argument that was put; that it may encourage more people to do it themselves.

Senator SHERRY—Even though where they have done it themselves—and in the case of Westpoint it was through self-managed super funds—they got burnt?

Mr Bateman—I realise that, yes. That is correct.

Mr Reed—It is also fair to say that if you look at the self-managed super funds that come across our desk for investment advising, you will find they are all very conservative in terms of how the money has been invested previously. It has generally been in fixed interest cash and some commercial property trusts, and that is about it.

Senator SHERRY—Is that a good or a bad thing?

Mr Reed—That is generally a good thing because it means that you get the opportunity to look at the whole span of investments for the client and balance their investment structures for the longer term, and do it properly.

Mr Bateman—What you are referring to is whether it has been a good thing for them in the past experience.

Senator SHERRY—In part, yes.

Mr Bateman—If it is not matched to their investment profile then it is a bad thing. If that is their investment profile, that is where they want to be.

Senator SHERRY—Wouldn't a person's investment profile be significantly weighted in equities?

Mr Bateman—Not necessarily. That depends on the individual, and that is what you have to flesh out.

Senator SHERRY—If you are going to be in a super fund for 40 years and you are going to hopefully live for another 20 or 25 years after retirement, surely a significant weighting in equities is the appropriate thing?

Mr Bateman—That might be your profile and my profile.

Senator SHERRY—I see Mr Murphy has put his hand up and is agreeing. I would argue it is anyone's profile. It has the highest long-term rate of return, unless you know when you are going to die—and obviously there would be some people in those circumstances—

Mr Bateman—I agree with you in that respect. If the client has a certain risk profile, you have to meet that risk profile.

Mr Murphy—I would like to answer that, Senator Sherry. I think there is still favouritism for property. That is one of the big things. Shares are a bogey. When you ask people about shares, their standard answer is: 'I don't understand. I have no control. I can see a property.' Really, in our portfolio, I would say we have to convince 90 per cent of our clients to take equities. It is not an asset class that they would have considered.

Senator SHERRY—In convincing them, I assume you believe that is the best long-term rate of return—diversified, of course.

Mr Murphy—I have to be very careful about the risk analysis that we must do under Financial Services Reform.

Senator SHERRY—Sure.

Mr Murphy—I take the position that most people in Australia have a property portfolio, even though it is their place of principal residence. They should be building their share asset class within their portfolio.

Senator SHERRY—I did not argue exclusively for shares. I said 'a significant weighting in shares'.

Mr Murphy—From an attitudinal perspective, consumers are still apprehensive about equities.

Senator SHERRY—The majority of Australians are in the default option, which is generally balanced—though I think some of the tags are misleading. It is the prudent person test, diversified, trustee's default option. The largest slice of the investment is in shares, then property and then a very small amount in bonds and cash—is it not?

Mr Bateman—If you look at different funds, between 60 per cent and 70 per cent would be in growth investments and the other 30 or 40 per cent is in cash and fixed interest. With your example before, you still have to ask why they have it in cash and fixed interest at all.

Senator SHERRY—Yes—maybe for liquidity purposes, I do not know.

Mr Bateman—That is true, but then we still have to get back to how much risk the client is prepared to take for the return they want to receive.

Senator SHERRY—It is a complex argument. I would argue it is not high risk provided it is diversified. I would argue 'high risk' is putting all your money in cash or bonds, because you know what the outcome is going to be.

Mr Bateman—We need you on our side! When are you going to come to work with us?

Senator MURRAY—Mr Chairman, I do not understand this question and answer session. It seems to me to be predicated on the view that consumers are not entitled to reject advice; that they are not entitled to decide on how they will invest their funds. Providing their conduct of their SMSF is prudential and within the regulatory mechanism, it is their entitlement.

Senator SHERRY—But it is not if there are limitations.

Mr Murphy—Senator Murray, I think what Senator Sherry is saying is that they do not make a choice as the majority of their funds are left in default options within funds.

Senator MURRAY—So where are you going with this? Do you want to mandate that people must not only get advice but also take that advice?

Mr Murphy—No. I think the problem is that they do not get the advice. It is probably fair to say that most employees' superannuation balances are made up of employer contributions. They have still not come to the realisation that it is their money, therefore they have not made choices and so it resides in the default fund of the employer.

Senator SHERRY—Which is why the default fund design is critical.

Mr Murphy—Exactly.

Senator SHERRY—And there is effectively no default fund design in an SMSF?

Mr Murphy—I think there is confusion as to an SMSF. The SMSF market is beyond probably most of Middle Australia and supposedly there are intelligent people making the decisions.

Mr Bateman—An SMSF has to have an investment strategy, and that is supposed to be followed.

CHAIRMAN—I have a question while we are on this issue. You have highlighted the importance of disclosure. Even allowing for disclosure, if I pay a fee for service I can certainly expect, so I can be pretty sure, that you are going to be batting for me. But if you are receiving remuneration by commission from the product that you are going to advise me to invest in, how do I know whether you are batting for me or whether you are batting for the product provider?

Mr Bateman—In our practice, Senator Chapman, you would have a choice. If you want to write a cheque out we would be happy to receive your cheque. But if you say, 'Look, I'd rather pay for that out of the superannuation,' we would deduct the fee from your superannuation balance. It is your choice, so it is about what you want to do.

CHAIRMAN—In that case if you are deducting it from my superannuation fund I am still paying for it.

Mr Bateman—You are paying for it—that is right.

CHAIRMAN—But what if the fund manager is paying you the commission, rather than it being taken out of—

Mr Bateman—It can be dialled down to zero, and you have given me the cheque so we are all square.

CHAIRMAN—I understand that.

Mr Murphy—You are still paying the fee.

CHAIRMAN—Yes.

Mr Murphy—That is it in essence. It does not matter if it is coming from the fund manager or if it is coming from your cheque book. It does not make any difference; it will be the same.

Mr Bateman—It is about choice. People still need to have the choice of both options depending on their financial position.

Ms BURKE—What about if you are a person who has a licensing arrangement to sell a specific product? If someone comes to see you and you sell them X, you get paid a commission by the product provider, not by the client; the person that you are advising does not pay you anything. You have said to them, 'Take this product'—I am not going to name one—'because it is really good and there is no fee involved.' What they do not know is that you have just pocketed 2,000 bucks from the company to provide that product advice to make them take that product—and that does happen.

Mr Bateman—That does happen. I think that is unethical. The client is still paying, whether it is a no entry fee scheme or whether they pay a cheque or whether it is taken out as a lump sum. Transparency and disclosure is what it is all about. They have to know through the disclosure document that they are paying a fee one way or another.

Senator BRANDIS—Mr Bateman, I must say I get a bit weary of hearing people invoke disclosure as if it is the answer to every problem in this field. What that does not tell you is that many people who go to investment advisers to seek advice about superannuation products are financially ignorant, so if you disclose the matter to them then it is not going to make any impact. It might not even register with them what the product provider is telling them. How do we deal with this issue of financial illiteracy and with the asymmetry of information between the adviser and a financially unsophisticated client?

Mr Bateman—I tend to think that most of my clients when they come to see me are financially illiterate. Therefore, it is our role to educate them about what is available, what we expect of them in managing their financial affairs, what their goals and objectives are and what their risk profile is. That is part of our education process; that is what we get paid to do: to help them. I agree with you that they are in a very vulnerable situation. You mentioned disclosure. We have been dealing with this for many years. The issue is that legislation does not bring about ethics; ethics come from the heart. You cannot legislate for ethics. The same would apply in your profession.

Senator BRANDIS—There are some ethical positions that can and should be legislated for. What you probably meant to say is that not all ethical positions can be legislated for.

Mr Bateman—You could say that. But then if it is not in the heart it will not be delivered to the client.

Senator BRANDIS—Yes, but you are talking about an arms-length relationship, too. The public are entitled to rely on something a bit more certain than the goodness of the adviser's heart.

Mr Bateman—I agree with you. But current FSR arrangements and an ethical adviser make a pretty good match to make sure that things go right. I understand that there are a few bad eggs around, but that does not mean that the whole lot are bad eggs.

Senator BRANDIS—No. But they are the people who we need laws for. You write the laws for the bad people, not for the good people.

Mr Bateman—I know; I realise that.

Mr Murphy—On that, it would be fair to say that we are getting far more people asking how we are remunerated. Even with the financial services guide, which has to stipulate and lay that out, when we conduct interviews it is commonplace for people to ask: 'How do I pay for this? Do I draw a cheque?' We will say that they have a choice: they can either draw a cheque or we can take the remuneration out of the product, and we disclose what that amount is. It would be very unusual for someone to sell one specific product. The other thing is that we see the press talking about this issue of advisers being biased towards one particular product. It would be fair

to say that across the market the remuneration in terms of commission on all product within an environment is pretty much the same.

Ms BURKE—But there are some planners and advisers who are linked to one product. If you disclose that, that is fine. But if you have not disclosed that your product name is wholly owned by a major bank and the individual does not know that and thinks that they have walked in to see an adviser rather than a licensed agent, that is where the difficulty arises. Then they wonder why they have walked out with all of these similar products. I suppose it is about the disclosure regime and whether you are providing holistic advice or whether you are actually selling a product. That is where we started at the beginning of the day: is it advice or is it selling?

Mr Bateman—In my view, the advice comes first and the product is chosen to provide the solution to the client's needs.

Mr Klipin—Disclosure is key and critical, but the longer term solution is education. You have seen pretty much all of the mainstream press—television shows, websites and so on—driving education to consumers. The literacy foundation is another key part. If we start education about finances when our kids are in school, we will be better positioned to make informed decisions as we get to our 20s and so on. Obviously, because superannuation for all has only come in in the last 15 to 20 years, we have to grow people through that process. They now face key and important decisions about big amounts of money. There are practice based things and then there are broader industry things that can happen.

CHAIRMAN—I take it from what you said a moment ago, Mr Murphy, that the particular product that you recommend will not make much difference to the remuneration that you receive. Whether it is product A, product B or product C, the commission is going to be a similar percentage.

Mr Murphy—Yes, generally speaking. Senator Sherry raised the issue about the price being paid for putting certain products into licensees' hands. But that money is going to the licensee; it is not, in a lot of cases, going to the adviser. So there is not a lot of difference on that.

Senator BRANDIS—It seems to me that that is only half the question though. The amount of commission is largely uniform, but if the product adviser has only a single client which is paying him commission then obviously he has a vested interest in making the sale to the member of the public who might seek his advice. Therefore, for that reason—not because it forecloses choice but because there is an obvious financial incentive in completing the deal—he is going to be very tempted to ensure that the member of the public who seeks his advice purchases the product. If they do not then he does not get the commission.

Mr Murphy—True.

Senator BRANDIS—That is a problem, is it not?

Mr Murphy—Yes, it is a problem, but it is part of the relationship process. You may not make a sale—if you want to put it that crudely—until the second, third or fourth interview. And I think we are seeing more of that coming about now. We are looking towards being responsible

for a far broader spectrum of financial products for a client. It tends to become a client-adviser relationship over time.

Mr Klipin—That is really why advice has been unbundled from the process. In days gone by people could only get paid if they 'sold the advice'. Now the quality of the advice is important, irrespective of whether there is an implementation piece, and that is why, increasingly, practices like the three you see here will negotiate with clients at the front end and they will have a model to operate. They do not want to do the work for no benefit and, equally, the client is not going to get any benefit if they do not actually implement and go ahead with anything.

Senator BRANDIS—But you cannot exclude the possibility, can you, under the current arrangements that you might have an investment adviser who obtains commission from one source only and who, because of the incentive and the temptation that that presents, recommends the acquisition of that product to a client while privately considering it not to be in the client's best interests. That would be unethical behaviour of course, but under the current arrangements it is not unlawful, is it?

Mr Bateman—Provided they meet all the disclosure requirements, no, it is not unlawful.

Senator BRANDIS—Which goes back to my first point, that we have to look beyond disclosure as the be-all and end-all.

Mr Murphy—I think, added to that, part of the function of FSR has been that the majority of advisers are actually receiving remuneration from one source, although that source has a plethora of products. It would have been a better choice had they gone down the original line, which was individual licensing of advisers. We did not get that, so now we have to deal with what we have. I think it is a better situation than it has been previously, but in the AFA's submission back in about 1999 we said that the biggest fear we had was that we would go back to a tied adviser relationship, which meant the major distributors virtually corralling the advisers and which was what we went away from during the 1990s—and it has happened.

CHAIRMAN—That brings me to your second issue under 'any relevant matters', which is the disclosure of the ownership of the dealer. That is not required at the moment under disclosure?

Mr Murphy—In your financial services guide you have to nominate the licensee. The ownership—

Mr Bateman—It is, I believe.

Mr Reed—The licensee can be owned by whoever but you do not have to disclose who owns the licensee.

CHAIRMAN—And you think that should be mandated?

Mr Reed—Absolutely.

Mr Bateman—That one is a simple one.

CHAIRMAN—What about the suggestion—you may have been here when I raised it earlier—in one of the submissions, which was that we have three categories of advisers: the franchisees, who are only tied to one product provider; the agents, who might be involved with several; and the so-called independents, who can go where they like to provide product?

Mr Reed—We have discussed this before as a group. There comes a degree of difficulty with that. If you describe yourself as independent, under the current legislation you may not receive any sort of trail commission or service fee at all. Therefore, if the deputy chair comes to me and wants an income protection policy, I am not allowed to charge her a fee for that or receive a commission. I must give her an invoice and must receive a cheque. That is the definition required of independence. Unless the laws change in terms of the definition of independence, it will not happen.

CHAIRMAN—I think that, of those three categories, the independent category was suggested to be the one which does only charge fee for service.

Mr Reed—I would probably meet 99 per cent of the independence criteria because the dealer in securities that I work to does not prescribe a platform or a brand. So I have the six or seven life insurers, the 100 or 120 fund managers and all of the superannuation suppliers and I recommend industry funds and I manage my clients' affairs inside industry funds. So there is not much to be gained by categorising the second tier a franchisee, which is perhaps somebody who is locked up to AMP or one of the other companies and can only sell AMP product—and I am sure that everybody has read the website on enforceable undertakings—and the other type of adviser as somewhere in between.

Mr Bateman—Senator Chapman, were you alluding to that Treasury paper a couple of days ago?

CHAIRMAN—I think that was in there. I thought it was in one of our submissions; I may be mistaken. You read so much that sometimes you do not remember the source of your information.

Mr Murphy—I think what you have is the tied bank type adviser that has a very limited range of products; you have the adviser that is an authorised representative of a licensee who gives you a choice on their recommended products list; and you would have the very few that I think, as Mr Reed has said, have a licensee or their own licence that gives you access to all products in the marketplace. But as to that independent tag that Senator Murray refers to, we are not allowed to use the word 'independent'. I think the word we use is 'non-aligned'.

Senator BRANDIS—Well, that makes all the difference!

CHAIRMAN—But in essence you are saying that it would not add much to the client's store of knowledge.

Mr Bateman—Did you have a view on that move?

Mr Reed—The chairman and deputy chair should consider a new category called 'non-aligned', which gives us a fourth category.

CHAIRMAN—But I suppose if we had this provision to disclose who owned the licensee, the client would, you would hope, get an understanding that if that particular product has been recommended it is because it comes down through that line.

Mr Murphy—Yes, the brand would be identified—and, let’s face it, those who manufacture product are all about building brand.

Senator MURRAY—I think that somehow nomenclature has to be found which is understandable for the broad mass of consumers. Most of the descriptives used at present are not understood. People understand ‘financial adviser’ but nothing else. I have used the analogy before that, in liquor sales, people used to understand exactly what a tied house was. Rarely are we talking about consumers being able to understand when a financial adviser is tied and when they are not.

Senator BRANDIS—Of course, one way of doing it, which, as you know, is the case in other areas of commerce, is to have a mandatory requirement that, even if it is an adviser who only deals in the product of one product provider, they invite the customer to seek independent advice. Is there a mandatory requirement to that affect under the existing law? I am not sure.

Mr Murphy—No, it is a recommendation.

Senator BRANDIS—So, one thing this committee could potentially recommend to address this issue is to make it mandatory that every adviser recommend to a client that they take independent advice, for example, from their accountant or from some other independent person who one would expect would be, in the case of a financially unsophisticated customer, more financially sophisticated than them.

Mr Murphy—With respect, Senator Brandis, it is very difficult because you would then generate this group of independent advisers who would not be independent at all. You and Senator Sherry have both said that it is the lack of will of the consumer to seek the appropriate advice that is the difficulty. They are having this money paid into their accounts by their employer—this is in superannuation—which is really the trigger now for people getting advice. They do not have ownership of that yet, and that is why more has to be done to give them a perspective of what that is for them, what it means to them.

Senator BRANDIS—I understand the difficulty. I just suggested it as a possibility. But I am monumentally underwhelmed by the suggestion that disclosure is enough. When one is speaking of a financially unsophisticated or financially illiterate person, it seems to me that disclosure really does not mean anything.

Mr Klipin—It really comes down to disclosure, education and letting the market prevail. If people are happy or not happy, they will vote with their feet, as tends to happen. We think that education is a critical part of it and disclosure on its own, we agree with you about.

Mr Murphy—To add to that, the biggest problem—and I think it was in the *Weekend Australian* and the *Financial Review*—is that there is still a cynicism by the consumer about the environment of superannuation. That is the big issue: to get them over that line. That plays into our hands because we get more money to deal with. But people have taken the position of

asking: ‘Will the government hold their will on the direction in which we are going at the moment?’ I think we all have to do more to convince the public that it is the solution for retirement.

CHAIRMAN—Turning to promotional advertising, in your submission you accept that the cost of advertising is a legitimate industry or retail fund expense but, again, you are looking for greater disclosure, more transparency and specific transparency of advertising costs?

Mr Klipin—Yes. On 31 August we released a press release around the industry fund debate, ‘Industry funds: The AFA says stop jumping at shadows’. Our message to our membership was simply that we absolutely support what industry funds do and we absolutely support that they have a role to play in the marketplace, and that if financial advisers spend their time concentrating on industry fund advertising and not focusing on their clients and the value that they deliver then we think they may be missing the boat. Our message was: ‘So let us focus on where we deliver value to our clients and let the industry fund market do what it is going to do, and let us leave the debate at that.’ Clearly, around the issue of advertising, yes, there needs to be transparency, but our message to our members was: ‘Focus on what you do best and let the market prevail.’

CHAIRMAN—In respect of the concepts of ‘not for profit’ and ‘all profits go to members’, you suggested that there should be regulation via APRA to ensure uniform reporting to members. Could you enlarge on what you meant by that and what should be reported.

Mr Reed—Our concern was that the reporting should be uniform. In other words, if we are being asked under FSR to provide a comparison to the client between funds A, B, C and D then we need some way of having a uniform outcome. Notwithstanding that we can research the websites and look at a comparative between funds A, B, C and D, and two might be industry funds and two might be public offer, we are being forced by the regulator to provide an absolute connective between all the costs and structures of those funds.

All we are asking is for the committee to say that perhaps it is not a bad idea to have some uniform reporting process of the MER, the cost of administration, the member fee, exit fees and all those sorts of things. They need to be standardised, and it is a pretty simple process. If we as advisers are being asked to provide full disclosure to the clients on all of the alternatives we offer, which is what we should do, then the committee and the parliament should say that there should be a standard methodology to report this.

Ms BURKE—Were you here when ASIC said they did not think they should have a standardised form? You cannot standardise; that was more or less the argument.

Mr Reed—ASIC have their view and the ATO have their view. The ATO have a view that you can standardise forms. The ATO view is that you can standardise a superannuation rollover form, and it probably consists of two pages. Our view would be that you can standardise anything and I am sure Senator Murray’s view would be that the accounting standards now being imposed by the parliament on the corporations of Australia for an increasing level of disclosure are uniform. We see no reason why the parliament cannot ask, by regulation or by simply having ASIC ask, all the super funds to report all the basic stuff equally. It is not rocket science.

CHAIRMAN—You put the view that there are no not-for-profit funds and that the statement ‘all profits go to members’ is an untruth. What is generally understood by not-for-profit is that all of the earnings of the superannuation fund after expenses go into the members accounts. With a for-profit fund that might similarly occur but within the expenses there is an element that goes to the shareholders of the service providing organisation in addition to what might be the normal cost of operation. You do not draw that distinction?

Mr Reed—We are simply saying that there should be full disclosure of all the cost structures in not-for-profit funds. It is as simple as that; let the members know where the money is being spent, as they have to be with public offer funds. You cited the case of a Western Australian super fund where, due to arbitraging on the unit prices, the fund had significant loses and some people made significant profits. The question is: do the trustees of that fund meet the sole purpose test? Are they looking at the sole purpose tested fund and the members as being the reason the trustee is there in the first place? In this case we are asking the question and making the point to the committee: why can’t we simply have all the disclosures on not-for-profit funds on the table?

CHAIRMAN—At the moment they are not?

Mr Reed—No.

CHAIRMAN—Is there any disclosure by not-for-profits?

Mr Reed—Some.

CHAIRMAN—But not to the same extent as in the case of for-profit?

Mr Reed—No.

CHAIRMAN—Thank you for your assistance with our inquiry.

Proceedings suspended from 3.43 pm to 3.48 pm

LIND, Mr Robert John, National President, Association of Independent Retirees Ltd

RITCHIE, Dr James Barry, National Chairman, Retirees Income Research Group, Association of Independent Retirees Ltd

SAVA, Mrs Helen Patricia, Company Secretary, Association of Independent Retirees Ltd

CHAIRMAN—Welcome. I invite you to make an opening statement, at the conclusion of which I am sure we will have some questions.

Dr Ritchie—Just before that, could I submit—

CHAIRMAN—Sorry, I did not refer to your submission. That is an omission; I apologise. We have before us your submission, which we have labelled No. 19. Are there any changes, alterations or additions that you wish to make to the written submission?

Dr Ritchie—Yes. We would like to submit the national survey of members that was just completed last week.

CHAIRMAN—We will receive that as an additional submission, thank you. I now invite you to make an opening statement.

Dr Ritchie—Thank you. AIR represents self-funded retirees. Membership is about 15,000 across Australia. It is not an elite group, in that its members' average income is $53,300 a year. Half of its members have superannuation pensions, and about 15 per cent of members are trustees of SMSFs.

Our interest today is primarily in the SMSF area. There are three basic issues that we would like to raise. The first is that we believe that, despite the very wide perception out there in the community that SMSFs do not meet the requirements of the intentions of the government in the act, the fact is otherwise and the evidence shows that. The second is that the compliance process which is operated by the ATO is not an appropriate one and does not meet the objectives of government in terms of the outcomes that the government is looking for. The third is that there are a number of regulations which are either inconsistent or give unintended consequences that add significantly to the costs of funds. That is where we come from.

CHAIRMAN—Thank you very much. Could you elaborate on your suggestion in the submission that structural changes to superannuation mean that the tax office is no longer suited to regulating self-managed funds.

Dr Ritchie—It is not appropriate for it. I think there are two reasons for that. The first is that the changes to superannuation mean that when retirees get to the draw-down phase of superannuation they pay no tax on the income from the assets. They pay no tax on the pension income. And if they are over 75 they are not able to contribute to superannuation. So the regulation of those funds really should be very simple, because the funds have few issues in

them that concern the regulatory process and they have no tax consequences, so from that point of view the ATO is not the appropriate body.

The second issue is a somewhat different one. It relates back to the regulation which requires members to be trustees. There was a debate earlier today about the number of member trustees in an SMSF. But if the number goes above two then the administration of an SMSF becomes enormously complex. It becomes complex because all the names of the trustees have to be on the titles, and the changes of the titles of ownership are a complex process. Indeed, a lot of the forms and regulations of clearing houses and equity companies do not allow for that number of names on the thing. Furthermore, there are not enough lines on the computer program, so half the address gets left off. Then there are all the costs of transferring the names of those assets. So that has complicated the process quite dramatically.

That has led to the strong development of corporate trustees. The latest ATO documents show that about 35.4 per cent, I think, of trustees are corporate trustees today—that is, over a third. Those corporate trustees are regulated both by ASIC and by the ATO, so that a corporate trustee has to be registered with ASIC and pay an annual fee to ASIC, and it has to pay the regulatory fee to the ATO and fill in different regulatory forms. It is a complex process. So, since the SMSF process was formed and the ATO took over, there has been significant change which has really emerged out of those types of issues.

We believe that the problems are complex enough without having a number of regulatory bodies involved. We believe that the regulatory bodies should have the power of enforcement. APRA does not have that, but ASIC does. We believe that there should be one body. Our preference is for ASIC. But, whichever way the government came down, the more important principle is that there should be only one body that regulates the industry.

CHAIRMAN—If you have this move towards corporate trustees for self-managed funds, can you just clarify for me whether, if you have a corporate trustee, all of the members of the fund have to be directors of that corporate trustee?

Dr Ritchie—Yes, they do, but the ability to change is much simpler and the title of the fund is much simpler.

CHAIRMAN—Yes, I understand that.

Dr Ritchie—Also, the administrative costs of clearing houses and share companies and all sorts of other things goes down quite dramatically.

CHAIRMAN—So if you are in a family structure you might have a corporate trustee of other trusts or whatever, but you still have to have a specific corporate structure to be trustee of your superannuation fund?

Dr Ritchie—Yes. Because of the requirement in the act that says that the funds must be held independently, that corporate trustee can only be a corporate trustee of a superannuation fund. That is quite true.

Ms BURKE—One of the issues that we were talking about with the planners before—and your group can best talk about this—is that we are concerned about people going into super funds. I also have a great concern about people coming out of super funds, the majority of whom have never known a large sum of money—it was nicely sitting in the super fund and they just ignored it and let somebody else care about it and worry about how to invest and where to go. But we seem to have forgotten about people who are about to retire and get that whack of money and wonder what they do with it—whether they put it back into a super fund or into an allocated pension or whatever. Do you have a view about the provision of advice to those individuals? I know that the association gives out a range of very good advice. Who should you go and see and how should you go and see them? Should you pay up-front fees? Have you looked into those areas? Do you think we need to provide greater regulation about that or should we be providing more financial literacy information so that people are making informed choices about ensuring that what they think is a huge lump sum of money is actually going to last their retirement?

Dr Ritchie—There are two points about that. Firstly, our association really represents people who through their lives have been much more conscious of their money and investment. Many of them have invested for their retirement—most of them have—right through their lives outside of the compulsory superannuation type system. I doubt that there is any member of our association that had compulsory superannuation. There might be one or two, but not too many. From that point of view, those members are much more financially literate and I do not think that issue arises so much. For other people who are approaching retirement or getting close to retirement and see a large nest egg there, the real answer from our point of view is education, not regulation. Regulation simply adds complexity to the system and makes it harder for people to understand what is happening. Education under those circumstances is the principle that we would apply.

Ms BURKE—How would you deliver that education? It is obviously not going to school kids. These are adults—these are individuals who are about to retire. I have asked this of ASIC on numerous occasions as well as the ATO and APRA. How do we actually get that information to that group of people?

Dr Ritchie—There are a number of approaches. There is a very strong push, supported by a number of large companies, for improving financial literacy generally. Those programs have been first focused on the young people, but AIR is trying to get that established for people in the 50 to 55 age group. NICRI do a lot of work. FIDO, on the ASIC site, does a lot of work. So I think there is a lot of education there—it is a matter of getting it across. There has been a lot of assistance in doing that. One important group is Centrelink. Centrelink does a pretty good job of letting people know what is happening.

Ms BURKE—The financial information service officers in Centrelink provide a very good service. A lot of people do not realise that the information is there at their finger tips.

Dr Ritchie—Yes, and not only that: people who are retiring will go to Centrelink as a first call.

Ms BURKE—If we are going to educate people and say, ‘Go and get advice,’ does the association have a view on commissions, up-front fees and that sort of thing?

Dr Ritchie—We take the view that the marketplace should essentially determine those things. The reason for that is that quite a number of people when they are about to retire or are retired want to get advice from a number of people. They do not want to pay a fee to every one of those people to get advice, so if they are going to pay an up-front fee they are almost locked into one person. But if they adopt the commission model, they can go to a number of people at no charge and they can then determine the best approach. So it is a bit of horses for courses. In our view, from the considerable experience of our members, it is better to leave that open because the providers of services will meet the market need. Some will operate on commissions and some will operate on fee for service. The only one requirement we have is that there should not be any trailing commissions and there should be legislation to remove those. They cause a lot of credibility problems and a lot of disenchantment, and there is no real rationale for them. But, otherwise, we believe the market should determine it.

CHAIRMAN—I asked the financial advisers who appeared prior to you a question about commissions generally and trailing commissions in particular, and they justified them on the basis of the FSR requirement for an annual review of their clients' circumstances. Do you not accept that?

Dr Ritchie—I hear the justification, but the consumers take a totally different view of that. They do not perceive there is any value in that.

CHAIRMAN—You, along with several other submitters, have suggested that the limit of four members for self-managed funds should be abolished. Others have suggested that it should be increased to nine. You have suggested a directly related party definition. Could you expand on what you would regard as a directly related party? Is it intergenerational; and, if so, how many generations?

Dr Ritchie—I think the people who propose that it go up to nine or 10—and I think in our submission we state that there needs to be some sort of limit—would also define that those nine or 10 people should be directly related parties. I do not think there is any question about that.

Senator MURRAY—In a genetic not a financial sense?

Dr Ritchie—In a genetic sense. There are a number of definitions in the legislation in different places that define 'related parties'. We believe that the best thing is to adopt one of those. One of the reasons for it—and I guess I can give you the example of my own case—is that we are getting old and we are going to die pretty soon.

Senator MURRAY—Don't do it today, will you!

Dr Ritchie—We have an SMSF, and there is a concern about who is going to deal with that when we die. If the executor also has superannuation in that fund, as a trustee member, then you have confidence that the process is going to continue through. Then you get to the next stage of how many of your sons or daughters want to be in that fund. We happen to have three. We happen to have a fight with them whenever one of them wants to be nominated without the other two being involved. Because the other two also have superannuation and they want to be in the fund, we really need five members to make that work effectively. So it is not an arbitrary thing; it is a family related thing that we suggest. Many other people are in that position.

CHAIRMAN—The argument was raised by, I think, the tax office that if you have more than four members the management gets too complex because of each member having to be a trustee; you would subsume that by moving to a corporate trustee structure.

Dr Ritchie—We believe there should be a lot more done by the various regulatory bodies to encourage people to consider corporate trustees. You will find in the publicity that they are not mentioned at all. Furthermore, you get very bad advice from lawyers who say, 'Don't do it,' but 35 per cent of people do it very effectively. There is no education about the best type of trustee structure an SMSF should adopt. You still run into problems in that if one member of the SMS dies then you have to restructure the whole thing, which is complicated in a trust situation but much simpler in a corporate trustee situation. You also have to reduce the costs of the regulation of that so that duplicate costing is not involved.

Senator MURRAY—Mr Lind, how do people become members of your association?

Mr Lind—At this point in time, it is principally by word of mouth. We have 80 local branches, so it is a question of recruiting people with a like mindset. We are the only seniors' association that starts from talking about financial and lifestyle issues rather than it being a social situation. As Barry said, it is people who have managed money through their working life who want an ongoing involvement.

Senator MURRAY—I am interested as to whether you think you are representative of independent retirees in a class sense, not in a specific sense. I ask you the question because evidence to this inquiry has convinced me that consumer information in this field is relatively poor, unstructured and weak. Government, Treasury and legislators, I think, are at a disadvantage because, to an extent, we have to guess to put ourselves in the shoes of consumers to decide on policy. How do you think consumer information can be better gathered in this field of retirement planning?

Mr Lind—Certainly we as an organisation are going through transition. I am almost a baby boomer and I think like a baby boomer. I can see that there is a greater need for education. One role that our association needs to take on is not necessarily to give advice but to point people to where they can get good advice. There is lots of good advice out there; it is a question of directing people where to go. People will need not only financial planning but also transition planning: how do I take the lifetime skills I have learnt through my work environment to a retirement environment, and how do I marry the two together? Associations like ours need to find the funds to be able to take on that role and to become a disseminator of information, if you like.

Senator MURRAY—In my head is an interest in whether the committee should consider the issue of seed funding for associations to get them up and going basically as an advocacy route. It is done, as you know, by governments in the environmental field, the community field and the business field, but I am not conscious of it having been done in the area of retirement income planning or financial advice. Do you think that is a legitimate area for the committee to think about?

Dr Ritchie—Yes. I will add something to that. From the survey, we would qualify it to say that the association gives a very good representation of active self-funded retirees. People who

are ill, not active and not able to move around generally drop off the membership, so you find it is distorted because of that fact. Otherwise, it is a reasonable representation of those between 65 and 90. It does not represent the percentage of the community in the below-65 group at all, and, primarily because people are not so active in the above-90 group, it does not represent the proportion of that community. But, in the 65 to 90 group, we believe it pretty well represents the proportion of people in the community.

On the second point, we have already had some discussion with the ATO—we meet regularly with them a couple of times a year—about the notion of doing some project work funded by the government on some of these consumer related aspects. The ATO believes that that is well worth looking at at this point of time. So we would support funding on a project basis but not funding of organisations, if I can put it to you that way. We want to stand independent of the government.

Senator MURRAY—Let us test that. There are many organisations funded by governments which are very independent. The government, for instance, funds many church organisations that engage in education, health and employment, but they are still very independent in their advocacy. But I specifically used the words 'seed funding'—to essentially get them up and going. After that, they would need to stand on their own feet. Do you consider yourselves to be an advocacy group? Do you have an infrastructure and a secretariat that provides regular submissions and detailed advocacy on behalf of this sector?

Mr Lind—We are mostly a voluntary group but we are organised as an advocacy group, yes. As well as Barry's group, we have two other research groups. We have a secretariat here in Canberra working for us. So, principally, we are advocacy, followed by information. From talking to the baby boomers coming through, they also see the need for a group to represent them as advocates, so it is something that we need to continue to do.

Senator MURRAY—Looking at another area of the information you have provided, I think, Dr Ritchie, you made the remark that most of your members are not dependent on superannuation. Did you mean pensions?

Dr Ritchie—No. Fifty per cent of our members have superannuation of some form or other. I used the term 'superannuation pension' to embrace the different types of superannuation.

Senator MURRAY—I am looking at table 15 in your submission. It says there that 58.6 per cent have superannuation. Are those who have superannuation principally from defined benefit funds or superannuation guarantee set-ups or something else?

Dr Ritchie—There are very few defined benefit funds left in Australia. We think of the government sector as untaxed superannuation funds. They may be defined benefit funds. In the corporate sector there are virtually no defined benefit funds left.

Senator MURRAY—No, I am referring to your membership. I wondered if they were skewed in any particular area. Are they skewed in terms of where their superannuation comes from?

Dr Ritchie—No. If you go back to one of the previous tables you will find which are Commonwealth super, which are state super and where it comes from. Table 11 will give you some idea.

Senator MURRAY—I am sorry; I have not had the chance to work through this.

Dr Ritchie—Table 10 gives you the types of pension incomes. Only 0.6 per cent of our members—very few—have a full age pension, 17 per cent have a part age pension, 5.1 per cent have a DVA pension and 2.5 per cent have a disability pension. Quite a substantial number have overseas pensions—11 per cent. There is another group we cannot define, which is 11 per cent. ComSuper is 7½ per cent, other Australian government super is 0.5 per cent, state government super is 12 per cent and company super is 5.1 per cent.

Senator MURRAY—Is a typical profile that they might have, separately: investment income of some sort, which might include annuities, a superannuation stream and their self-managed superannuation funds? It is a mix of those?

Dr Ritchie—Yes. You can get that from table 15, which is the first you were looking at. If you look down the table there you will see that it asks whether they have all of their income from government pensions or superannuation and whether they have a major part or a minor part from those areas. So that will give you an idea that the highest percentage has a number of different types and that only 24 per cent have only superannuation and nothing else.

Senator MURRAY—You would be familiar with the term ‘demographics’. Are you familiar with the term ‘psychographics’, the psychology of why people do things? Have you done any work to establish why people enter into self-managed super funds?

Dr Ritchie—Not from a formal survey, only from talking to members. There are two fundamental reasons. The first is that the people we represent are used to managing their own funds, and they want to continue to do that. The second is that they see it as a useful activity to engage in after they retire; it is something to do. That is an important reason that many organisations and the government have not understood. When people retire they want to be active and want to do things. We want to encourage them to be active and to do things. Managing their affairs is one form of activity.

Mr Lind—There is no useful psychographic information available in Australia. There is some that comes from the USA, but that is not the same profile as Australia’s. I am familiar with psychographics because I have used it in the business sense, but I have not been able to find any information anywhere, or any support software, that could in fact help us to do that. It is something I would like to do because I think it would be very interesting.

Senator MURRAY—Frankly, Dr Ritchie, they could do in retirement what you suggest without needing to be in a self-managed super fund. They could invest in property and manage their property, or they could invest in shares and so on. My instinct is that people put it into a vehicle for many reasons, not all of which I would be able to anticipate: firstly, they accept that it is a regulated activity; secondly, they have a prudential motive—in other words, it is cautionary and precautionary approach; and, thirdly, it is low risk.

Dr Ritchie—Yes, but there is a fourth—that is, there are substantial tax advantages. The primary reason for moving into SMSFs is the tax advantages.

Senator MURRAY—How frequently do you survey your members and how costly is it to do this sort of research? You have produced this paper, which has been tabled, entitled 'National Survey of Members 2006'. Is that an expensive, long-term, difficult and costly activity?

Dr Ritchie—There are two parts to your question. The last survey was done in 2003. The one before that was done in 2002, from memory. This is the most extensive of them and it was done essentially by voluntary labour. Its total cost was about $7,000, and the rest has been voluntary labour.

Senator MURRAY—To pursue what Mr Lind and I understand as psychographics would be some time away and you would have to do a lot of preparation before that, wouldn't you?

Mr Lind—The experience is that we would need to source a software package to be able to do it. There are those around. The last one I saw split the Australian population into about 36 psychographic groups. The retiree population would be something less than that. But you certainly need the software because it merges the ABS data and the proprietary psychographic information together to get the profiles. That would be more expensive in the sense that we would have to find a provider with that software to licence it to us.

Senator MURRAY—I am asking you these questions because I am concerned that in some quarters there is a motivation to add additional compliance and regulation to SMSFs based on assumptions about, and some data on, their management, which I think may be misguided and not based on empirical data. The only way to establish that is to do decent consumer research.

Mr Lind—A danger will be with overregulation in the withdrawal stage. But where the cost of regulation and keeping the fund is more than the tax payable then people will take all their money out of superannuation and put it into a bank account. The costs of regulation will cause people to act in a particular way. If regulators want to keep money inside the superannuation scheme because there is some regulation then they need to be very careful with the cost of keeping it in there.

Senator MURRAY—Your suggestion that the SMSFs should have an enlarged member capacity raises the possibility of consolidation where families have constituted two or more funds because of the five-member restriction—especially extended families. Have you thought through how consolidation could be achieved? What transitional arrangements need to be in place?

Dr Ritchie—It depends on the way the funds have been set up. A very large proportion of funds have the total funds held in a consolidated form and they are proportioned off each year amongst the different trustees. There are not too many funds that have assets isolated and held in the name of each trustee, because that is a complicated and difficult way of doing it. I would think that the problems of amalgamation would not be very high.

CHAIRMAN—You would need a capital gains tax rollover test, wouldn't you?

Dr Ritchie—Yes, for transfer between the funds there would be a capital gains tax involved.

CHAIRMAN—I note your suggestion that self-managed funds should only be audited for the first three years and then, subject to satisfactory outcomes, no further auditing should be required. What informs that view, and what is its purpose?

Dr Ritchie—I guess it goes back to this issue: what is the most cost-effective way of having compliance regulation on the industry? The tax office process is one that relates to the tax office auditing a certain number of high-risk funds and auditors auditing every fund, but that process is not efficient because the relationship is between the trustee and their accountant—78 per cent of all trustees use accountants to prepare their accounts. That is in documents here. The client relationship is between the trustee and the accountant. The tax office approach is to the auditor. The auditor then has to check information from the trustee. That is checked through the accountant to the trustee. It can only be done, and is done, by getting signed statements from trustees that they have not entered into any loan arrangements, that they have conformed to the act, that the trustees are eligible. They are all signed statements from that auditor to the accountant to the trustee and back from the trustee to the accountant to the auditor.

That is a complex process which does not really achieve anything. The tax office said today that they were concerned that auditors were good at auditing the accounts but not at the compliance requirements, and that is the reason for it. If the focus is on accountants, and the accountants are properly trained and educated and meet the regulatory requirements, the trustees and the accountants will achieve the same thing. We have said to the ATO that the design of their regulatory forms and checklists should be consistent for the trustee and the accountant. If that happens, and if they demonstrate that they conform, the need for auditing those funds is not such a requirement.

We go further to say that we recognise that, afterwards, a fund may become nonconforming, even with the accountant there, and in that case the penalty should be that that fund will be audited from then on for a very lengthy period so that there is a carrot approach rather than a stick approach in the system. If that was the focus, there would not be the need to audit every fund every time. We need to recognise that the cost of that regulation is now very high. It is approaching $250 million. The cost of the audit fee and the cost of the $150 tax fee now comes close to $250 million. That is a very high cost on funds that have a relatively small $300,000 type trust which has a very simple structure in general. That is why we say it is wrong and that the audit process should be changed to reflect that. If a fund does not use an accountant, as in my case, it should be audited every year, because there need to be checks and balances but you do not need double checks and double balances.

CHAIRMAN—Do you regard that as a valid recommendation, considering the apparent breaches that the tax office is finding with managed funds?

Dr Ritchie—Our submission points out that, in fact, breaches which affect the aim of the act—that is, major breaches that affect the proper use of the funding for retirement—are very few. We have listed them. For assets not in the name of a fund, for example, fewer than 0.03 per cent of funds are in breach. You could say that is because the ATO does not check enough, but the ATO requires every fund to be audited, and the audit contravention reports do not show that there are a large number of people outside that group. The evidence is quite clear that, for the regulatory issues which affect the proper use of the funds, the funds comply. It is the trivial things that are not compliant. For example, people submit late. ASIC handles that by having a

penalty and that is a much better approach than having a fee for everybody who submits on time. The regulatory form has a lot of things in it that people do not enter properly. For example, the form asks, ‘Are you retired?’ After that, it asks, ‘What industry are you in?’ When people do not fill that out because they answered yes to the question on retirement they get a phone call from the tax office saying, ‘Please, fill that out and we’ll put you down as a non-compliant fund.’ There are a whole set of those things. When you copy from the formal accounts to the regulatory form because the regulatory form is back to front there are errors of transcription that occur all the time. If those things were fixed you would find that funds comply to a much greater extent than the tax office indicates at this point in time.

CHAIRMAN—You are saying that the real level of noncompliance is much lower than the tax office figures—

Dr Ritchie—Yes, it is very small indeed.

Senator MURRAY—And the material level of noncompliance is low.

Dr Ritchie—Yes, very low. But it is a nice model that the ATO have set up, I have to say.

CHAIRMAN—Regarding the capital requirement issue, I think your recommendation is similar to the AFA’s—that the same capital requirement should apply to—

Dr Ritchie—All funds.

CHAIRMAN—all arms-length funds. Your recommendation, as I said, reflects what AFA, who appeared just prior to you, said, but that seems to be at odds with most of the other submissions we have received. They say that the prudential requirements in relation to industry funds and the like are quite adequate, but you do not share that view.

Dr Ritchie—We say that there should be consistency. There is no logical argument for having different prudential requirements in different types of funds if those funds are arm’s-length type funds from the contributors. That is really what we are saying. Otherwise, I think you get into self-interest arguments.

CHAIRMAN—If a capital adequacy requirement was introduced for industry type funds, would they then have to generate a return on that capital for whoever was providing it?

Dr Ritchie—I think the answer to that is yes for all funds. To lock funds away without at least being able to earn interest on them does not make logical sense in any type of fund. It is where the money is lodged that I think becomes the important thing.

CHAIRMAN—So what would be the purpose of that capital?

Dr Ritchie—It is to guard against the problem of the fund incorrectly investing or some such thing and not having sufficient funds to meet its superannuation requirements.

CHAIRMAN—And mispricing of units?

Dr Ritchie—Mispricing of units, yes—all sorts of reasons.

CHAIRMAN—Thank you very much for your appearance before the committee and for your help with our inquiry.

Committee adjourned at 4.32 pm