REVIEW OF THE SUPERANNUATION INDUSTRY (SUPERVISION) ACT 1993 AND CERTAIN OTHER SUPERANNUATION LEGISLATION

SUBMISSION TO THE PRODUCTIVITY COMMISSION

MAY 2001

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INTRODUCTION

The scope of our submission is limited to the Superannuation Industry (Supervision) Act 1993 ('SIS Act') and the Superannuation Industry (Supervision) Regulations 1994 ('SIS Regulations').

At the outset, we suggest that the present legislation can be considered to provide a fundamentally sound framework for achieving the broad policy objectives of retirement incomes in Australia. Unfortunately, however, the legislation seems to have become bogged down in too much detail as a result of all of the amendments to it. Many of these amendments have only served to introduce restrictions, more prescriptive measures and complexities to the superannuation system. Consequently, there is less focus on the core principles such as the sole purpose test than on, for example, whether an asset can be acquired from a related party.

GENERAL ISSUES

Areas of Complexity
Alternative Means of Achieving the Objectives of the Legislation

The major areas of complexity in the legislation from the perspective of small superannuation funds are the investment restrictions imposed by section 66 (acquisition of assets from related parties) and Part 8 (in-house assets) of the SIS Act. We acknowledge that these provisions have been specifically excluded from the scope of the Commission's present inquiry. However, the recent amendments to these areas exemplify a process of adding layers of complexity through increased restrictions (arguably with no clear justification), stifling competition and opportunity, and doing little to further the broader objectives of superannuation and retirement incomes policy.

In relation to the investment rules applicable to regulated superannuation funds, the system has essentially developed into one of prescribing all the things that a trustee is not permitted to do, instead of concentrating on the positive aspects (such as the sole purpose test, investment strategy requirements, arm's length requirements, etc).

There are also complexities in the areas concerning the preservation of benefits and the acceptance of contributions by funds. From a prospective viewpoint, preservation should, however, become increasingly less complex following the major changes that became effective from 1 July 1999. Conversely, the rules governing the acceptance of contributions by funds require, in our view, some significant improvements to deal with obvious inequities and anomalies in the current provisions. This aspect is covered separately later in the submission.

SISFA remains committed to the notion that more education of trustees and enforcement of existing regulations are required, rather than the introduction of new, more restrictive provisions.

LEGISLATION-SPECIFIC ISSUES

Rules Governing Operations

Small APRA Funds

These are funds with fewer than 5 members that can not or do not satisfy the criteria to be self managed superannuation funds, and are consequently required to have an approved trustee. Save for the fact that these funds have an approved trustee, their membership and other characteristics closely resemble those of self managed superannuation funds. We consider that there is some scope for the legislation to make accommodation for such funds by relaxing their reporting and disclosure requirements where it is quite clear that none of the members is at arm's length in relation to the others.

Annual reporting

For funds other than self managed superannuation funds, we consider that the time for lodgement of annual reports required under the SIS Act must be reviewed. Currently, such funds must lodge their annual statutory returns with APRA within four months of the end of the applicable financial year. Our experience suggests that this requirement is often a physical impossibility, given the number of outside parties who must be relied upon by the trustees of a fund to meet their financial reporting and audit obligations.

Funds, other than public offer funds, were previously allowed a period of six months to lodge their returns, which is a more realistic time frame for trustees. Furthermore, SISFA is curious to know what benefit was intended to be obtained by truncating the previous lodgement timetable.

Acceptance of Contributions

Following a review of current legislative provisions and strong feedback from members, SISFA proposes changes to the standards restricting the acceptance of superannuation contributions. The proposed changes will remove the upper age limit for voluntary superannuation contributions and simplify the superannuation contribution acceptance standards across all ages.

We believe that the major aspects of this proposal could be implemented with relative ease in the short term and will benefit all Australians by:

promoting broader superannuation coverage;
removing barriers to participation in superannuation;
encouraging continuing participation in the workforce by older Australians;
removing some of the inherent complexities of the current system; and
reducing discrimination based on age, marital status or employment status.

Details of SISFA's proposal are set out in a separate submission that is included as an Appendix hereto.

Portability of Benefits

There is inconsistency in the portability of benefits as between Australian superannuation funds and their overseas counterparts . At present, regulated superannuation funds in Australia are permitted to accept transfers of benefits from foreign pension schemes or similar vehicles, but **not** vice versa.

The Government has indicated its favour for "bilateral negotiations with other countries to facilitate reciprocal agreements for the transfer of superannuation benefits by non-residents on permanent departure from Australia" (Taxation Laws Amendment (Superannuation Contributions) Bill 2000, Explanatory Memorandum, pp10-11). We endorse this approach, but seek a firmer commitment from the Government to commence the process and address this portability issue.

Investment Rules

While the Commission's terms of reference preclude a review of section 66 and Part 8 of the SIS Act, we suggest that any review of the superannuation investment rules from an overall perspective will be incomplete without at least some consideration of those aspects.

Section 66 – Acquisition of Assets from Related Parties

We submit that section 66 has become unnecessarily complicated.

With the sole purpose test, arm's length requirements, and investment strategy standards embodied in the existing SIS Act (coupled with the in-house asset rules and restrictions such as section 65), it seems that section 66 does not serve an all too constructive purpose.

SISFA stands behind the basic principle that it is the **use** of an asset, and not the party from whom it is acquired, that should dictate whether it can be acquired and held by a superannuation fund. This position is best expressed in the following question:

> *If a superannuation fund can purchase an asset from an arm's length party, where that asset accords with the sole purpose test and the fund's investment strategy, is there any good policy reason why that fund should be prohibited or restricted from purchasing the same asset (on commercial or arm's length terms) from a related party?*

Our preferred solution is to simplify section 66 while preserving its underlying policy and perhaps even improving its effectiveness. In this regard we recommend that the current section 66 be reviewed and amended along the following lines:

- retain a prohibition from acquiring assets from related parties, but only in relation to assets that are used for domestic or private purposes by a related party; and
- continue to require that all such assets are acquired at market value.

(In the case of real property, reference to the use of the asset could be extended to "predominantly for domestic or private purposes".)

This proposal is essentially consistent with the arm's length requirements contained in section 109 of the SIS Act.

Part 8 – The In-House Asset Rules

The in-house asset provisions in the SIS Act were originally designed to protect members' benefits by limiting a superannuation fund's investment exposure (direct or indirect) to an employer-sponsor's, or associate's, business. The provisions quite clearly were only intended to apply to loans to, or investments in, an employer-sponsor or associated entity, and for good reason. Such a loan or an investment by a superannuation fund **directly exposes** the fund to the risks of the employer's business. It is inappropriate that an employer should potentially have access to working capital arising from concessionally taxed contributions made by or on behalf of its own employees.

The same cannot be said, however, for investments in unit trusts or assets leased to associated parties on commercial terms. The acquisition of units in a unit trust is **not** an investment in the entity that is the trustee of that trust. Rather, it is an investment in the property that is the subject of the relevant trust deed. On this basis, it is conceivable that where a related trust invests (by way of a loan or otherwise) in an employer-sponsor or associated entity, the current in-house asset provisions should have effect.

Similarly, an asset leased to a related party (on commercial terms pursuant to section 109, of course) does not necessarily represent direct exposure by a superannuation fund to that party's business. In such an arrangement, the asset generally has an underlying value independent of the entity to which it is leased.

The recent extension of the in-house asset rules to cover investments in related unit trusts and assets leased to related parties was unnecessary, has increased the complexity of the investment provisions, and will stifle future commercial investment opportunities—particularly for small superannuation funds.

The Investment Rules Generally

SISFA asserts that more attention should be, and have been, devoted to the fundamental investment principles embodied in the sole purpose test, investment strategy standards and arm's length requirements. This is lieu of the focus on the investment restrictions that we have experienced over recent times that have simply caused confusion, more complexity and increased costs.

Regulated Superannuation Service Providers

The Audit Process

We consider that the role of the approved auditor will become increasingly important in the regulation of superannuation funds, particularly self managed superannuation funds. In fact, the audit process should go a long way to achieving a self-regulating industry. The requirement for superannuation funds to be audited interposes a layer of regulation and supervision between trustees and the relevant government agency (APRA, ATO or ASIC).

We believe that this mitigates the need for the government regulators to review or audit superannuation funds in Australia on an individual basis, and allows more efficient allocation of resources.

As auditors are subject to their own professional standards in addition to the obligations imposed on them by the SIS Act, we would not consider a regime of licensing trustees to be appropriate. However, there may be scope to improve the standard of the current audit process by requiring that an "approved auditor" for self managed superannuation funds, in addition to being a member of one of the prescribed accounting bodies, must also have been sanctioned by a yet to be established "Small Superannuation Funds Auditors Review Board" (akin to the Company Auditors and Liquidators Review Board, or the Tax Agents Review Board).

It is doubtful in our view whether an extension of the SIS Act obligations imposed on auditors and actuaries to administrators and other service providers would achieve any benefits. Auditors and actuaries are engaged by trustees to perform certain prescribed prudential supervisory functions, being functions that trustees could not carry out themselves. Administrators and other service providers simply carry out duties that could ordinarily be performed by the trustees, and are more in the nature of advice, routine administration, and attending to tax and other statutory reporting obligations.

Actuarial Requirements

Any regulated superannuation fund that pays a lifetime or life expectancy complying pension must comply with the actuarial standards set out in Part 9 of the SIS Regulations. The APRA-imposed standards applicable to these types of pensions require an actuary to certify that there is a high probability that a fund will be able to meet its future pension liabilities (previously, the standard was for a reasonable probability). Compliance with this standard typically results in a lower income stream being able to be provided from a given level of assets.

Gross inconsistencies arise when such pensions are assessed by the Department of Family and Community Services (DFaCS) for social security purposes, and by the Australian Taxation Office (ATO) for determining the exempt pension income of the fund. The criteria used by both DFaCS and the ATO for valuing these pensions are different to those imposed by APRA.

The result is typically that an amount will be assessed by DFaCS to have been gifted, and the fund's assets that are supporting the pension will not be totally exempt from tax—despite the fact that APRA required a higher asset value in the first place in order to provide the pension.

Such outcomes reflect inconsistent application of policy by the relevant government agencies, and are clearly not in the best interests of consumers. SISFA recommends that the actuarial standards applicable to lifetime and life expectancy pensions are developed and administered consistently, to restore clarity and remove the unintended consequences identified.

As a general proposition, it should not be unreasonable to expect at all times that current retirement incomes policy reflected in the superannuation legislation is supported consistently and concurrently by related income tax and social security legislation.

Administration and Enforcement of the Act

APRA/ASIC/ATO – Demarcation of Responsibilities

The ATO's relatively new role as a regulator under the SIS Act has clearly defined boundaries—it is responsible for the provisions of the SIS Act relating to self managed superannuation funds. Notwithstanding this position, many of those provisions are also the responsibility of APRA or ASIC in relation to non-self managed superannuation funds. There is a risk therefore of regulatory overlap and the potential for inconsistency or uncertainty. We have already seen evidence of differences of opinion occurring among the regulators on particular issues, through the publication of superannuation circulars.

Less clear, it would seem, are the roles that APRA and ASIC play in their shared supervision of the rest of the regulated superannuation market. We are aware, and the SIS Act stipulates, that APRA is responsible for the so-called "prudential" aspects of the legislation, with ASIC assuming responsibility for the areas relating to disclosure or consumer protection issues. However, it seems to us that this divided supervisory approach does not work well in practice, and may result in regulatory inefficiency or leakage.

For example, some of our members have reported recent instances of being reviewed by APRA as part of its routine supervision program. In relation to any member reporting aspects of a fund's operations, APRA expresses its "informal" opinion but makes it patently clear that this area is now the responsibility of ASIC. If APRA forms the view that a fund's disclosure to members is deficient, it expects some comments from the trustees, which, if unsatisfactory, may result in the matter being referred to ASIC. This can hardly be seen as an efficient regulatory process. Furthermore, from a trustee's perspective, being accountable to only one regulator must be a preferable situation.

We welcome the opportunity to discuss any aspect of this submission in further detail.

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For and behalf of SISFA

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APPENDIX:

PROPOSAL TO INCREASE SUPERANNUATION COVERAGE AND SIMPLIFY SUPERANNUATION CONTRIBUTION ELIGIBILITY STANDARDS

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Introduction

Following a review of current legislative provisions and strong feedback from members, SISFA proposes changes to the current standards restricting the acceptance of superannuation contributions. These changes will remove the upper age limit for voluntary superannuation contributions and simplify the superannuation contribution acceptance standards across all ages.

We believe that the major aspects of this proposal could be implemented with relative ease in the short term and will benefit all Australians by:

- promoting broader superannuation coverage;
- removing barriers to participation in superannuation;
- encouraging continuing participation in the workforce by older Australians;
- removing some of the inherent complexities of the current system; and
- reducing discrimination based on age, marital status or employment status.

Policy Proposal

To achieve the objectives outlined above SISFA proposes the following broad amendments to the current contribution acceptance provisions that apply to non-mandated superannuation contributions.

- **Removal of Upper Age Limit for Non-Mandated Contributions**

  SISFA proposes that the upper age limit of 70 for non-mandated superannuation contributions be removed to allow individuals of any age to make additional voluntary contributions to superannuation at any age.

- **Simplification of Acceptance Standards for Non-Mandated Contributions**

  SISFA would like to see the current contribution acceptance standards, based on employment status or marital status (i.e. eligible spouse contributions rules), removed completely at all ages.

Alternatively, we believe that the major objectives of this proposal could be achieved in the short term by relatively minor amendments that would:

- remove all acceptance conditions based on employment status or marital status for individuals under age 65; and

- retain contribution acceptance standards based on employment status (consistent with the employment conditions relating to the compulsory cashing of superannuation benefits) beyond age 65.

In summary, implementation of the proposed amendments would result in the following acceptance standards for superannuation contributions.

Mandated employer contributions – may be accepted by a fund in respect of a member of any age (i.e. no change to the current provisions).

All Other Contributions - may be accepted by a superannuation fund:

- in respect of a member under age 65, in any circumstance (i.e. regardless of the member's current or past employment status or marital status);
- in respect of a member age 65 but less than age 70, only if the member is gainfully employed on at least a part-time basis; and
- in respect of a member age 70 or over, only if the member is gainfully employed on a full-time basis.

Implementation

The proposed amendments would not require major legislative review and could be implemented by:

- an amendment to Part 7 of the Superannuation Industry (Supervision) Regulations 1994; and
- corresponding amendment to Part 5 of the Retirement Savings Accounts Regulations 1997.

Our proposal does not require a corresponding amendment to the Superannuation Guarantee Administration Act 1992. Instead, it would simply permit the continuance of contributions after age 70 if a bona fide link with gainful employment were maintained. In other words, there would be no compulsion for employers to contribute for employees over age 70, but at least the option to do so would be available.

Background

Impact of Compulsory Cashing Restrictions

SISFA believes that the current compulsory cashing requirements that specify when a member must receive, or commence to receive, payment of monies held within the superannuation system negate any need for an upper age limit on the acceptance of contributions.

These compulsory cashing restrictions act to ensure that superannuation savings are used by an individual for retirement purposes and not held in a concessionally taxed environment for estate planning purposes.

In summary, the current compulsory cashing conditions require individuals to receive, or commence to receive, their superannuation savings, in each of the following circumstances:

- where they have reached age 65 and are no longer gainfully employed for at least 10 hours per week; or

- where they have reached age 70 and are no longer gainfully employed for at least 30 hours per week.

The amendment outlined in this proposal would ensure that the contribution acceptance standards for superannuation contributions on behalf of members over age 65 are consistent with these compulsory cashing requirements.

Elimination of Perceived Discrimination against Singles

The current contribution standards that apply to individuals under age 65 allow contributions to be accepted for any member under age 65 who can satisfy the definition of spouse regardless of their employment status.

This aspect of the current superannuation system is often perceived to represent discrimination against single Australians. To demonstrate this concern, we could compare the current treatment of a couple (whether legally married or members of a defacto relationship) who have never been gainfully employed, with the treatment of a single person who has not worked for a period of more than 2 years:

> Superannuation contributions for both members of the couple could continue to be accepted until they reach age 65 despite the fact that neither of them have ever worked; whereas
>
> Superannuation contributions for the single person may not be accepted unless they commence gainful employment or meet an alternative contribution standard.

The amendments proposed by SISFA remove this anomaly and alleviate this concern by providing for the consistent treatment of couples and singles in relation to the acceptance of superannuation contributions.

Consistency with CGT Retirement Exemption Provisions

The current CGT retirement exemption for small business owners is not subject to the upper age limit of 70 that applies to voluntary superannuation contributions.

This effectively provides some small business owners with an opportunity to increase their superannuation funding beyond age 70 that is not currently available to employees or taxpayers otherwise ineligible for the CGT retirement exemption in the same age group.

In a similar vein, an inequity or anomaly arises in relation to other employer ETPs. Such an ETP, in respect of a person age 70 or over, may be rolled over to a superannuation fund by virtue that roll-over payments are not included as contributions for the purposes of the contribution acceptance provisions.

The proposal outlined in this document would address this anomaly by extending the range of individuals able to fund superannuation savings after age 70 to a broader range of individuals.

Need to Encourage Continued Participation in the Workforce by Older Australians

Currently, it is estimated that more than 75% of individuals over age 65 receive some form of commonwealth income support.

The percentage of the population over age 65 is expected to increase by around 40% over the next 20 years (from 2001 to 2021) and this significant increase is expected to further increase the strain of funds for commonwealth income support benefits.

Based on current life expectancy tables an average 70 year old male is expected to live for almost 13 years, while a 70 year old female is expected to live for a further 16 years. The life expectancies at these age groups are expected to continue to increase with improved experience over time.

Important implications of these observations were noted by the Council on the Ageing (Australia) ("COTA") in its media release dated 20 March 2001:

> *"This means that there will be more older people and less working age people. It will mean lower labour force and productivity growth, fewer taxpayers, more people needing support and a decline in national savings. The result – the rate of economic growth will slow and our standard of living will decline.*
>
> *"According to the OECD, though, if countries like Australia can keep people in work for more years this will have a significant effect on living standards.*
>
> *"Encouraging people to remain in work an additional 5 years could mean a 14 per cent higher living standard in the European Union, 18 per cent higher in Japan and 10 per cent higher in the USA. Australia would follow these patterns. The average age of retirement for men in Australia is 58.*
>
> *"Australians are living to healthy, advanced ages and this poses a problem for retirement incomes. We argue that the present system has not taken the longevity of Australians into account. If Australians can continue longer in work and avoid drawing down on their superannuation for at least a few years, this will dramatically improve the superannuation available to them over the long term".*

The trend towards early retirement has generally been acknowledged to be a concern for the Australian economy that has prompted the introduction of certain regulatory developments such as:

- the gradual increase in female age pension age from 60 to 65;
- the increase in the superannuation preservation age from 55 to 60; and
- the deferred pension bonus scheme which was designed to provide individuals with an incentive to remain in full-time employment beyond age 65 with potential access to the maximum incentive being made available to individuals who remain in full-time employment until age 70.

SISFA believes that the proposed amendments would achieve significant benefits consistent with current retirement incomes policy objectives.

Removing the upper age limit of 70 and simplifying the acceptance conditions for voluntary superannuation contributions will assist in encouraging older Australians to continue to participate in the workforce and provide additional flexibility to allow individuals to fund for their retirement.

Previous Policy Positions

The Federal Coalition, in its policy paper "Superannuation for All – Security and Flexibility in Retirement" released in February 1996, stated that it would:

> *"Allow persons over age 65 to continue contributing to a regulated superannuation fund where they maintain a bona fide link with the paid workforce (i.e. are gainfully employed for at least 10 hours per week)".*

We acknowledge that this measure was implemented in the form of raising the upper age limit from 65 to 70. However, we note that the original policy proposal did not refer to an upper limit at all.

The policy paper went on to say that:

> *"One very important aspect of Coalition policy over the last decade has been the recognition that age should not be a barrier to employment.*
>
> *"Moreover it [the age restriction on contributions] provides additional barriers to workers seeking to adequately finance their retirement. The reality is that a number of people over 65 need to work, or want to work, to supplement their retirement income. The April 1995 ABS survey on retirement and retirement intentions found that 138,000 persons who had reached the compulsory retirement age for their job would have liked to have continued full-time work. The need to continue working is particularly true for those workers, especially women and migrants, who have participated in the paid workforce for less than the traditional 40 plus years.*
>
> *"Removal of the age based restrictions on superannuation contributions would provide women (and others whose paid workforce experience has been characterised by breaks) with a longer period in which to accumulate an adequate retirement income.*
>
> *"Irrespective of paid workforce experience the ability of those in the early and middle years of working life to contribute to superannuation is often limited. Removal of age based limitations would allow individuals to continue contributing to superannuation at a time when they are most able to afford such contributions".*

SISFA endorses these comments and offers them as further support for our current proposal.

We also note that our proposed amendments accord in principle with one of the recommendations made by the Senate Select Committee on Superannuation and Financial Services in their report on Enforcement of the Superannuation Guarantee Charge (see recommendation 12, para. 6.32, of the report, April 2001).

"Policing" the Eligibility to Contribute

Trustees are currently under an obligation to ensure that contributions are only accepted in the circumstances permitted by the SIS Regulations. Similar obligations are imposed in respect of satisfying the compulsory cashing restrictions, particularly when members attain age 65. Trustees are required to satisfy themselves that a member aged 65 or older continues to meet the relevant gainful employment conditions.

These obligations are further supplemented by corresponding responsibilities imposed on the approved auditor.

We believe that the proposal outlined in this document would simplify the obligations of trustees and auditors in relation to the acceptance of contributions significantly for members under age 65 and provide for a consistency of review obligations for both contributions acceptance and compulsory payment of benefits beyond age 65.