PRICEWATERHOUSECOOPERS

Productivity Commission Review of Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation

Submission by PricewaterhouseCoopers

May 2001

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1 Identification

At this Inquiry, PricewaterhouseCoopers (PwC) is represented by the following:

- David Coogan FCA Registered Company Auditor
Partner, Audit and Business Advisory Services

- David Knox FIAA
Director, PricewaterhouseCoopers Actuarial Pty Limited

- Gabriel Szondy FCA
Partner, Tax and Legal Services

- Len Gainsford B. Econ MBA
Partner, Pricing and Competition Policy

- Claire Keating, FCA
Director, Audit and business Advisory Services.

Queries on the submission may be addressed to any or all of these representatives by phoning (03) 8603 1000.

PricewaterhouseCoopers involvement in the Superannuation Industry

PricewaterhouseCoopers has a significant client base in the superannuation and funds management industry. The market may be defined as the market for professional services (Productivity Commission 2000 Review of Legislation Regulating the Architectural Profession). We provide compliance, external audit, internal audit, taxation, actuarial and investment consulting and a wide range of other consulting services to various approved trustees, corporate, public sector, industry and retail superannuation funds.

PricewaterhouseCoopers is also heavily involved in the industry through its partners and employees participating with industry groups such as the Association of

Superannuation Funds of Australia, the Australian Institute of Superannuation Trustees, the Investment Funds Association, the Institute of Actuaries of Australia, the Institute of Chartered Accountants and the Australian Society of Certified Public Accountants. Appendix I provides further background information on PricewaterhouseCoopers.

Prior to making this submission, PricewaterhouseCoopers ran a number of workshops to discuss the Productivity Commission's Issues paper. Over 20 funds representing corporate industry, public sector and retail funds participated in these workshops.

It was on the basis of these workshops and our expert knowledge through our client base in this industry, that we make this submission.

2 Requests

At this Inquiry, PricewaterhouseCoopers makes the following requests:

(a) the six pieces of legislation covered under the Reference should be retained, with some minor amendments as outlined in this submission. The primary objective of SIS must be to continue to provide a strong prudential framework for the superannuation industry.

(b) the Commission should recommend greater use of industry consultation (eg policy discussions with Treasury) to address problems identified in the operation of the legislation

(c) to varying degrees, the six pieces of legislation foster pro-competitive outcomes through business certainty, broad application and availability of information to industry participants and fund members

(d) there should be continued reliance upon audit opinions and advice from entities or individuals who possess the requisite professional qualifications and/or satisfy registration requirements

(e) the Commission find that each of the above requests is not inconsistent with National Competition Policy.

3 Reasons for Requests

Objectives of the legislation

Our general consensus is that the Superannuation Industry (Supervision) Act 1993 (SIS Act) is pro-competitive and provides a comprehensive legal framework for the good management of members' interests by Trustees. SIS is pro-competitive because it provides certainty through a strong prudential framework in the SIS Act and Regulations. These are also supported by various Circulars which APRA formulates and updates on a regular basis. The Circulars are extremely helpful in clarifying the application of the SIS Act and Regulations, which also helps manage compliance costs in the industry (mentioned at paragraph 3(e) to the Reference).

It is important to stress at the outset that the primary goal of SIS must be seen within the context of the need for a strong prudential framework for superannuation. In line with the Government's retirement income policy, employers are currently paying superannuation contributions of at least 8% of earnings for the vast majority of employees.

These employees do not have access to their superannuation moneys for many years and expect the system to operate with stability and security. Long term confidence in the Australian superannuation system is therefore essential for the Australian community.

Hence, it is critical that the SIS Act is viewed in this long term context and the benefits are not viewed within a short term time span. We recognise that such a long term analysis is difficult but a focus on the short term only could undermine the objectives of SIS and the long term confidence in superannuation that is essential.

We believe that whilst SIS is prescriptive it provides certainty in information and disclosure to members that Fund Trustees would have to provide anyway, if it were not for SIS. We

also believe there is a need to stabilise fluctuations in the industry so that Trustees can devote more time to building members' confidence. Replacing SIS with some other approach would be less optional.

In relation to measuring the costs and benefits of SIS, we believe that:

- it is difficult to measure the cost of complying with SIS on the industry, and that
- measuring the benefits is very subjective. If you did not have SIS then we would have something that reflected much of what was in SIS anyway and, as such, on that basis, complying with SIS is not seen as a major cost burden.

In relation to how well SIS accommodates technological and other market driven changes, we believe that whilst more fund members are starting to use email and the internet to access information in relation to their fund benefits, it will be two to three years before this becomes the significant communication source. The question is whether members should still receive hard copy information or whether internet and other means of communication are sufficient for SIS purposes. We would suggest that this is an area that needs to be closely monitored through various APRA Liaison Groups with input from other industries such as managed investments and consideration be given to how public company shareholders have information provided to them.

Costs of Legislation

In relation to the cost of legislation, we believe that:

- The costs of operating superannuation funds (including compliance costs) are significantly less than the costs of providing non-superannuation investment products to people. In the time available, we have not been able to carry out a thorough comparison. However, we are confident that most superannuation fund members receive a better overall return than from a comparable

investment product.

- Whilst there is a cost to compliance with the SIS Act and Regulations, funds are now comfortable with having to comply with SIS and do not see the cost of compliance as a major issue. As noted above, most of the costs would be present anyway, even without SIS, as they represent the activities of good trustees. One of the major benefits of SIS is that it brings uniformity to compliance within the superannuation industry.

- What funds are concerned with is the cost of complying with other legislation, for example the administration costs of administering the surcharge and the potential costs involved in having to be licensed under the proposed Financial Services Reform Bill (FSRB).

- The SIS legislation does not restrict competition in the industry. Rather, it sets a minimum standard of compliance for funds that is reasonable given the earlier mentioned prudential issues. Much of the focus of Trustees beyond compliance and providing members information as required under SIS, is with educating the members about how their superannuation fund is performing and how they can improve their retirement benefits through additional contributions and so on. Many funds have implemented Member Investment Choice and this has reinforced the need for Trustees to educate members rather than providing them with a lot of information.

Alternative means of achieving the objectives of the legislation

As outlined above, our view is that the current system works well. In addition to the legislation, the industry through its various industry bodies provides Trustee training, service provider training, best practice guidelines, etc which all supplement the prudential management legislation. APRA has also provided best practice guidelines to Trustees through its regular review program on funds and also through its Good Practice Guide publication "A Guide to Good Practice

for Trustees of Corporate and Industry Superannuation Funds".

Although there may be alternative approaches, (eg single responsible entity), we do not believe that an alternative approach would be cheaper and provide the same level of security and confidence that is required.

Legislation Specific Issues

Trustee Rules

Our view is that the Trustee system is the appropriate legal structure for superannuation funds. Trustees are responsible to the members of the fund and have a fiduciary responsibility to manage the fund as if it was their own money.

Section 52(1) of SIS requires all fund trustees to:

- act honestly in all matters ....
- to exercise....., the same degree of care, skill and diligence as an ordinary prudent person would exercise in dealing with property of another ....
- to ensure that the trustee's duties and powers are performed and exercised in the best interests of the beneficiaries.....

These covenants together with the equal representation system provide the fundamental base for beneficiaries' interests to be prudently managed. Given we are talking about people's retirement savings, we believe that the Trustee system is the appropriate structure as the responsibility of Trustees is aligned 100% towards the members' interests in the fund.

In relation to whether Trustees should be subject to some form of licensing regime, we believe there is little evidence to suggest that the current Trustee system has not delivered good results, that is, appropriate investment returns, good service to members and reasonable investment management, insurance and administration costs. In our experience, if

Trustees and management do not have the skills to manage the fund, industry experts are employed to fill the gap. Trustees are also heavily involved in industry forums that provide training. In particular, both ASFA and AIST provide trustee training and the AIST Trustee Handbook provides a wealth of knowledge to both new and experienced Trustees on their legal and other responsibilities in managing their fund.

However, we do acknowledge that there have been occasional failures. In the main, these failures have not been due to the structure of the system. Rather, there has been fraud or other inappropriate behavior. Whatever the system, we cannot realistically expect perfect behavior by all members of the industry. In this respect, we recommend that APRA or ASIC take prompt action where behavior is inappropriate, rather than there be a fundamental change to the system.

Rules governing operations

In relation to the detailed operating standards within SIS, we have identified a number of areas where SIS could be simplified to reduce duplication and to eliminate standards that do not achieve much. These include:

1. **Duplication between Aged Based Limits and RBL Limits**

Trustees and corporates have to establish administration systems that both monitor the deductibility of contributions and at the benefit payment level trustees also have to administer the reasonable benefit limits. The industry questions why there are rules at both the entry and exit level and whether one rule would achieve the government's objective. Our suggestion is that the aged based limits be eliminated on the basis that the RBL rules discourage people from contributing to fund benefits above their pension RBL. The existing aged based limits, also, do not allow people who have left funding their superannuation until their mid 40's to catch up the amount they need to contribute to build up an adequate retirement benefit. Another alternative to help

reduce compliance costs in this area would be to limit the level of individual contributions to, say, $100,000 per annum.

2. **Rules for employees between 65 and 70**

At present there are a number of administrative rules in relation to funds accepting contributions from people aged 65 and above. We believe that with an ageing population and the small number of people still working at age 65, such rules could be relaxed. The general consensus of funds at our workshops was that the costs of monitoring and complying with these rules outweighed the benefits.

3. **Overseas Visitors**

Workshop participants also believed the costs of administering rules in relation to overseas visitors working in Australia were both costly to comply with and provided very little benefit as once these visitors leave Australia, any benefits are quite often lost through either the member not keeping overseas address details up to date or the balance becoming too small for the member to worry about. The rules in relation to accepting such mandated contributions should be removed for people working in Australia temporarily or alternatively amounts should be paid out when the visitor leaves Australia.

4. **In-house Asset Rules**

Related to the in-house asset rules which are part of SIS is the SLAA 4 legislation that restricts the level of investment funds can have in associated entities. This legislation was put in place to control the level of investments made by self managed funds in related entities. The problem, however, is that this legislation now stops many of the larger corporate, industry and public sector funds from managing their own investments rather than using external managers. As such, this legislation is anti competitive and has resulted in additional and unnecessary compliance costs to many funds.

5. RMS Requirements

Circular II.D.7 requires fund trustees to have Part A and Part B risk management statements if their funds use derivatives. If funds outsource their investment management activities, they are required to obtain the relevant Part A and Part B risk management statements from their fund managers, have these RMS's reviewed and accept them and obtain external audit reports on an annual basis on their fund managers' Part B risk management statements. We believe that the requirements of the circular could be simplified to reduce the level of compliance cost but at the same time achieve the circular's objective of ensuring Trustees monitor and are aware of the level of derivative trading within their fund.

6. Key Features Statements

We believe the Key Features Statement requirements are overly prescriptive and that there is scope to develop a single template which provides the key information to prospective members. This single template should be adopted consistently so that members have the ability to more easily compare funds.

7. Small account balances

Several years ago member benefit protection rules were introduced so that members with account balances less than $1,000 could not be reduced if administration costs exceeded investment income credited to members accounts. In hindsight, we believe this legislation has produced inequities in the system and therefore is anti-competitive. Members with higher account balances are paying for the administration costs of smaller account balance members. We believe the real solution is for fund trustees to manage the level of small accounts and for inactive accounts to be transferred to an ERF. We also believe the administrative costs of complying with the member benefit protection costs are significant and cause inequities between members.

Investment rules

Other than the unnecessary and anti-competitive restrictions on funds in relation to compliance with SLAA 4, we believe that the investment covenants and other investments restrictions within SIS are not unduly restrictive or complex. The key elements of the legislation are:

- trustees developing an investment strategy that has regard to investment risk, diversification, cash flow needs, etc
- trustees complying with the sole purpose test
- trustees exercising the same degree of care, skill and diligence as an ordinary prudent person.

Our experience is that compliance with the sole purpose test can often become difficult and subjective, particularly in the area where some investments also involve providing ancillary benefits to members and/or the employers. In our experience, the key issue here is ensuring any such investments meet the trustee investment covenants without taking into account any ancillary benefits to members, that is, the investment needs to meet normal trustee investment criteria and due diligence in its own right. Guidance on these sorts of issues are provided through APRA Circulars which the industry finds most useful.

Regulated superannuation service providers

We believe that the current SIS Act requirements on investment managers and custodians are appropriate, given the responsibility of such providers to the industry.

In terms of compliance audits and the balance between the role of the external auditor and the surveillance role of the regulator, we believe that the existing system works well. Given the external auditor is involved in assessing and testing the internal controls of funds, we believe that from a cost effectiveness point of view that extending such work to testing compliance with SIS is an efficient use of resources for the industry.

The level of industry liaison between fund auditors and APRA has been extensive since the introduction of SIS and this has helped improve the compliance and prudential management practices of funds in the industry.

In relation to whether fund administrators should be regulated, we do not believe that this is an issue and is unnecessary in the current environment. The role of the Trustee is to administer the fund and where such responsibilities are outsourced the trustee has in place monitoring activities to ensure the quality of administration meets their needs. In appointing and monitoring administrators' performance, most funds have in place service contracts (many include performance standards with financial penalties and rewards) together with regular monitoring and reporting of these standards to the Trustee.

A significant level of competition exists in the market to provide administration services to the industry and in recent years a significant amount of investment has been going into internet, interactive voice response, service centre and other improvements which have increased the quality of administration in the industry. In our experience, market forces are helping address any problems with fund administrators. The focus needs to be on ensuring trustees are monitoring the administrators and have sound contracts with such providers. APRA has access under SIS to review the operations of administrators on a fund specific basis.

Administration and Enforcement of the Act

In relation to the administration and enforcement of the Act, we believe that:

- the roles and responsibilities of the three regulators are clear and cost effective and that there is no compelling reason to make any changes to existing powers and compliance procedures. However, when isolated problems arise, the public perception is that it is often not clear which regulator is responsible for what. Consideration should be given to either educating the public on how to distinguish between APRA and

ASIC's respective roles or alternatively move back to having two regulators (APRA and ATO) rather than three responsible for superannuation

- it was generally felt that the discretionary powers of the regulators facilitate compliance and that the use of APRA circulars are very cost effective as they provide guidance on interpreting the SIS Act and Regulations

- the costs of monitoring and compliance by the industry and the regulators are warranted given the amount of money invested in the industry and the expected future growth in retirement savings in the future

- the penalty provisions under SIS do provide appropriate incentives for Trustees to comply, however, it should be noted that the industry is generally against strict liability penalties as it is incompatible with the Trustee equal representation system. Such an approach is a significant deterrent in attracting superannuation trustees for funds. The industry is spending significant resources at present in reviewing compliance reporting processes to ensure compliance with the strict liability provisions of SIS.

Superannuation (Resolution of Complaints) Act

Our experience indicates that the Complaints Tribunal is working well. It facilitates the resolution of disputes and misunderstandings which would otherwise be very costly to resolve through the Courts. Most funds have found that complying with the Tribunal's requirements is simply a matter of copying information that has already been provided to members through their own internal complaints process and as such does not represent a significant cost to other members of their funds. In our experience we are aware that for some funds the cost and time involved in resolving complaints through the Tribunal is quite expensive, particularly for complex defined benefit funds and smaller corporate funds where they only have a small number of complaints. On balance we believe the current system is cost effective. However, we believe that at some stage in the

Complaints Tribunal process a charge should be levied on the member to ensure their complaint is a serious and properly considered complaint.

Superannuation (Financial Assistance Funding) Levy Act

We feel that, whilst this Levy Act has not been used yet, establishing a fidelity fund as an alternative was unwarranted and would add unnecessary complexity to the existing system. It was acknowledged that there have been some funds that have collapsed in Australia and that the recovery of assets to meet members' interests takes several years, however, it was still considered unnecessary from a cost effective point of view to change the current remedies available to members in this area.

4 Conclusion

Our overall conclusion from consulting within our own firm and through various client workshops has been that the existing SIS legislation is doing a very good job of protecting and managing the industry. We have raised a number of issues where SIS could be simplified from a cost/benefit point of view. Our clients do not believe that SIS is anti-competitive. They believe that the superannuation industry is, in fact, very competitive with fund trustees continually focussing on monitoring investment returns, fund managers and the quality and cost of administering their members' funds. Our clients believe that there is in fact a large variety of providers available to them in the market, namely corporate funds, industry funds, master trusts, approved trustees, small APRA funds, small managed superannuation funds and RSAs. There is also significant competition amongst service providers.

Again, we would stress that the primary goal of SIS is linked to the long term prudential supervision of individual's retirement savings. It is essential that the Productivity Commission keep this long term benefit in mind as it conducts its review.

The main concern we have is in relation to the impact that other legislation has on superannuation funds. In particular, Trustees are concerned about the costs of administering the surcharge (from an equity between member viewpoint) and the potential impact of legislation such as the Financial Services Reform Bill. The strength of the current system is that it provides uniformity to compliance within the superannuation industry.

Appendix I

PricewaterhouseCoopers

PricewaterhouseCoopers was formed by the merger of Price Waterhouse and Coopers & Lybrand on 1 July 1998 and is the world's largest professional services organisation helping its clients build value, manage risk and improve their performance.

With more than 150,000 people in 152 countries, PwC provides a full range of business advisory services to leading global, national and local companies and to public institutions.

PricewaterhouseCoopers has more than 6,000 employees in 18 locations around Australia. The firm has taken on the challenge to break the mould associated with traditional accounting and business advisory organisations to deliver "breakaway services".

The critical mass of the firm, its problem solving capabilities, global knowledge and industry capabilities enables the organisation to deliver the highest quality services anywhere in Australia and the rest of the world.

These services include audit, accounting and tax advice, management, information technology and human resource consulting, financial advisory services including superannuation, investment and actuarial, mergers and acquisitions, business recovery, product finance, litigation support, business process outsourcing services, and legal services through a global network of affiliated law firms.

Our lines of service, each with an array of specialised practices, reflect the demands of today's intensely competitive, technology-reliant global marketplace. We are among the leaders in each discipline, and can deploy skilled resources when and where needed by our clients.