Submission to the Productivity Commission's Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation.

Introduction

Finlaysons is a full service commercial law firm, based in Adelaide, with 18 Partners and around 50 legal staff, bringing total staff numbers to around 150. One of Finlaysons' specialist service areas is in taxation and superannuation. We have a number of superannuation clients, ranging from industry funds based in the eastern States, to corporate, public offer and self managed funds based in Adelaide. We have also recently established a dialogue with a number of corporate, industry and public offer funds following the establishment of our National Superannuation Fund Matching Service (the **NSFMS**) in February 2001. The NSFMS is designed to assist corporate superannuation funds that are considering amalgamation to identify potential amalgamation parties, as an alternative to winding-up and rolling over to a master trust or industry fund. Much of this submission is based on our experience with this client base.

We would also like to inform you that Mark Hancock, a solicitor and superannuation adviser at Finlaysons, has extensive superannuation regulatory experience, having worked for the Insurance and Superannuation Commission (**ISC**) and the Australian Prudential Regulation Authority (**APRA**) in Canberra and Melbourne from 1992 to 1999. While in Canberra, Mark was a member of the policy team that developed the Superannuation Industry Supervision legislation.

We have structured our comments using some of the questions raised in the Issues Paper dated March 2001.

General Issues

Does the legislation restrict competition in any aspect of the superannuation industry? For example, does it deter the entry (or exit) of superannuation funds, other providers of superannuation products, or other service providers such as accountants, auditors or investment managers? Are some types of funds subject to more onerous requirements under the legislation than others?

Reduction in the Number of Funds

There has been a significant reduction in the number of non-excluded superannuation funds since the introduction of the SIS legislation. The table below shows the number of superannuation funds, by fund type, as at June 1995 and December 2000.

Fund Type	June 1995	December 2000	Difference
Corporate	5,883	2,026	-66%
Industry	115	61	-47%
Public Sector	85	76	-11%
Retail	623	149	-76%
Excluded	95,033	216,907	128%

Source: Table s6, APRA Insurance and Superannuation Bulletin, December 1998, and APRA Superannuation Trends – December quarter 2000.

While we are unable to identify any specific areas within the legislation that are directly responsible for the large reduction in non-excluded superannuation funds over this period, we can pass on the following comments that have been made to us by clients, and potential clients, who have been considering either winding-up or amalgamating with other funds:

- Since the introduction of the SG, superannuation has become just another tax for us to pay, rather than an additional benefit that we were proud to offer our employees (from an employer considering winding-up their corporate superannuation fund);

- With choice of fund coming up, we don't think we can compete with the additional benefits being offered by the larger funds (from an employer considering winding-up their corporate superannuation fund);

- I'm concerned that one day a member is going to sue me, or a member will come up to me and say 'XYZ industry fund has returned 10%, how come our fund only returned 6%?'. What can I say, 'we tried our best'? I'd rather not have to worry about things like that. (from an employer representative trustee, discussing why he thought rolling over to a master trust or industry fund was a good idea);

- Everyone knows that superannuation is complicated. I'm tired of the changes to the legislation. The surcharge was difficult enough to get through. The changes in the penalty provisions to strict liability was the last straw. I've had enough. (from an employer representative during a discussion on the options available for winding-up the fund);

- We know that we need to grow to develop greater economies of scale, otherwise we might as well roll over into another industry fund. (from discussions with an industry fund considering amalgamation options).

Restrictions on New Approved Trustee Entrants

Section 26 of the SIS Act provides that APRA must approve an application for Approved Trustee status in certain circumstances. Firstly, APRA must be satisfied that the applicant can be relied upon to perform the duties of a trustee, then, if at least one of the following conditions apply, APRA must approve the application.

Briefly, the conditions are:

- the applicant has net tangible assets (**NTA**) of at least $5,000,000;
- the applicant has the benefit of an approved guarantee of at least $5,000,000;
- the applicant has NTA and the benefit of an approved guarantee of at least $5,000,000 in total;
- the applicant has agreed to comply with APRA requirements **relating to the custody of the assets** of the entities for which the applicant becomes trustee. In other words, all the assets of the fund are held by a custodian (which must have $5,000,000 in NTA or an approved guarantee) rather than being held by the applicant.

Subsection 26(3) of the SIS Act provides that APRA's approval can be subject to any conditions specified in the instrument of approval. While this provides APRA with a wide discretion in relation to the conditions it may specify, it is not an unfettered discretion. For example, the condition could not require the Approved Trustee to perform an illegal act. Further, the condition should relate to the Approved Trustee's activities as a superannuation fund trustee and not to an unrelated purpose. That is, as APRA's power to impose conditions is contained in a section dealing with deciding an application for approval, the condition should directly relate to the Approved Trustee's ability to satisfactorily perform the duties of a superannuation fund trustee, or to assist APRA's ongoing monitoring of the Approved Trustee's performance of those duties.

APRA have developed a standard instrument of approval which is issued to all Approved Trustees. Unfortunately, some of these conditions may result in a barrier to entry by new applicants, while other conditions may be beyond the power of APRA to impose (that is, APRA may only do what Parliament, through legislation, authorises it to do).

For example, condition D 1 provides, as a custodian condition, that the Approved Trustee must maintain at all times eligible assets of at least $100,000 and a level of liquid assets of at least $100,000. We consider that the imposition of these minimum asset levels may be beyond the power of APRA for the following reasons.

Parliament, in section 26 and regulation 3.03, has already specified the required asset levels, or failing those, custodian requirements for applicants. Therefore, as discussed above, APRA can only impose this condition if it can demonstrate that an entity with fewer assets cannot be relied upon to perform, in a proper manner, the duties of a trustee (s 26(1)(a)). To our knowledge, it has never been suggested that trustees of corporate funds require these levels of assets to adequately perform their duties as trustees. Trustees of corporate funds usually have only a small, or token, amount of assets. As the trustee duties for a corporate fund and a public offer fund are largely the same under Trust Law, the SIS Act and the relevant State/Territory Trustee Acts (other than a higher standard of care being required of professional trustees – see for example *ASC v A S Nominees* (1995) 133 ALR 1), it is difficult to see how an additional asset requirement for Approved Trustees could possibly relate to their ability to perform their duties as a trustee. This condition not only appears to be beyond APRA's power to impose but may also be a deterrent to new entrants.

In another example, condition A 15 provides that the Approved Trustee must not engage in any business or commercial activity other than as trustee of a superannuation entity. While the condition does provide some exceptions, we would have thought that such a serious restraint of trade clause would have been prescribed in the Act or Regulations (for appropriate Parliamentary scrutiny) rather than a subordinate instrument issued by a Statutory Authority. We consider this requirement to be unnecessary, overly bureaucratic and anti-competitive.

Is the legislation too prescriptive and unnecessarily complex? If so, what are the main areas of complexity?

Yes. The SIS legislation can be significantly simplified. Part 8 – In-house asset rules, is particularly complex and prescriptive. As is Part 25A – Tax File Numbers. The member disclosure provisions are also complex and arguably result in funds producing unnecessarily long documents that are rarely read by members.

Legislation-specific Issues

Does the requirement for equal representation of employers and members in employer-sponsored funds deliver significant benefits? Does compliance with it involve any unwarranted costs?

We consider the equal representation requirements have provided unquantifiable benefits in the overall confidence of members in the operation and management of their superannuation funds. This level of confidence is inspired by the actions of the trustees themselves and the recognition that in many cases they have an ability to nominate and vote for trustee member representatives.

Some concerns have been expressed to us by corporate fund trustees that while industry funds meet the equal representation requirements, member representatives are often appointed through nomination by a trade union rather than by direct nomination and election by members. Also, policy committees in master trusts have been seen to be of limited value because they have no power to direct trustees.

The main costs of equal representation are the conduct of the elections (frequency of elections vary, although three year terms are not uncommon) and trustee training. None of our clients have expressed the view that these costs are unwarranted or excessive (although we have not directly asked them this question).

Should all trustees be subject to some form of licensing regime?

As practitioners within the superannuation industry we can see no need for the introduction of a licensing regime for corporate fund trustees, given APRA's current powers of suspension and removal.

Are compliance audits an efficient means of monitoring compliance with SIS objectives? Do compliance audits reduce the need for surveillance by the regulators? Could the Act's requirements for compliance and financial auditing be made less costly?

Compliance audits are an excellent way of monitoring compliance with SIS objectives. Unfortunately for the legal profession, the legislation requires both

financial and compliance audits to be completed by 'Approved Auditors'. Approved Auditors must be, by definition, accountants. The legislation prevents the legal profession from completing and signing-off the annual compliance audit. This favouritism for the accounting profession in relation to compliance audits should be addressed.

We do not consider the requirement for annual financial and compliance audits results in excessive costs for funds. The audits provide trustees, fund members and the regulators with a level of comfort that the fund is financially sound and complying with the relevant legislative requirements.