Submission to the Productivity Commission's review of Superannuation Legislation

May 2001

A LEVEL PLAYING FIELD FOR SMALL APRA SUPERANNUATION FUNDS

Current Situation

The Superannuation Industry (Supervision) Act ("SISA") encourages related and associated parties to establish their own superannuation fund and to take control of their own superannuation by removing some of the investment restrictions normally associated with larger funds (the legislative framework of funds with less than 5 members is provided as attachment A).

Related and associated parties wishing to establish their own superannuation fund have the option of acting as the trustee of their own Fund (referred to as a Self Managed Superannuation Fund ("SMSF")) or appointing an APRA Approved Trustee as the trustee of their Fund (commonly referred to as a small APRA Fund ("SAF")).

Since 1991, TOWER Trust has been a major provider of SAFs and today acts as the APRA Approved Trustee and superannuation administration manager for over 4,600 SAFs Australia wide. In most cases members have specifically chosen the option of a SAF as opposed to a SMSF to avoid the additional responsibilities and associated risks of acting as a trustee, whilst still enjoying a high degree of investment control and flexibility not normally associated with larger funds.

The SISA and Income Tax Assessment Act ("ITAA") compliance status of SMSFs, is regulated by the Australian Taxation Office ("ATO"). The SISA compliance status of APRA Approved Trustees and SAFs is regulated by APRA. The ITAA compliance status of APRA Approved Trustees and SAFs is regulated by the ATO.

As part of APRA's regulatory regime, since the 1999/2000 financial year, SAFs have been required to lodge a copy of an annual audit report obtained from an approved auditor, a certificate of compliance signed by the Approved Trustee and an annual APRA return with APRA within 4 months of the completion of the financial year. Each SAF is also required to pay a minimum $300 per year to APRA for the cost of prudential supervision and the processing of these annual returns.

A SMSF is required to lodge its equivalent financial and other regulatory information with the ATO within 9 months of the completion of the financial year. SMSFs are required to pay a maximum $45 per year for the cost of prudential supervision and the processing of annual returns. It is apparent that the ATO has achieved processing efficiencies through the need to process over 200,000 SMSF returns annually. APRA, in comparison, is required to process approximately 17,000 returns, 6,500 of which relate to SAFs at a cost

of $300 per return (based on APRA December quarter superannuation trends and Treasury's May 2001 discussion paper on industry levies).

The Financial Sector (Collection of Data) Bill currently before parliament proposes that a minimum late lodgment levy of $550 per fund be charged for the lodgment of APRA returns after 31 October each year. It would seem that the proposal for the minimum supervisory levy is $500.

APRA places considerable reliance on the solvency, capital adequacy and operational capacity requirements that have to be met by each Approved Trustee to ensure the prudential management of SAFs. As part of this regime, APRA requires the directors of an Approved Trustee to provide a Prudential Management certificate and copies of the financial statements of the Approved Trustee within 4 months of the completion of the Approved Trustee's financial year.

Reasons for change

Over the past two years the required lodgment period for annual APRA returns has been reduced from 9 months to 4 months and supervisory levies have been increased by 50%. As the completion of fund audits, financial accounts and APRA returns by 31 October each year is an impossibility for many SAFs still waiting on unit trust and managed fund final tax statements for the financial year in question by that date, many SAFs now face the prospect of a $550 late lodgment penalty of top of a minimum $300, possibly $500, annual return fee.

To restrict access to such unit trusts and managed funds would be to compromise the flexibility and efficiency of the fund's investment decision making process compared to similar funds which operate without an Approved Trustee.

In the case of TOWER Trust, the huge logistical exercise involved in completing financial statements, fund audits and APRA returns for some 4,600 Funds within four months exposes TOWER Trust, and ultimately SAF members, to a potentially huge annual late lodgment penalty. One possible way around this dilemma is to prepare financial statements on a cash basis, instead of the current accruals basis. This would entail including unit trust and managed fund distributions as income and showing the tax liability as the actual amount paid during the financial year in question, or a close approximation of the actual liablity. The auditors are prepared to accept such financial statements as being the commercial norm but it is understood APRA are reluctant to do likewise. However, it should be pointed out that even this contingency does not lessen the huge logistical exercise involved in completing financial statements, fund audits and APRA returns for some 4,600 Funds within four months

We believe it is important that people who choose to utilise small funds have a choice between them, or an associate, being trustee or transferring that responsibility to an Approved Trustee. The current rules discriminate against SAFs and have the very real possibility of making the offering of such a product non-viable. Such an outcome would

result in the protection and expertise afforded by an Approved Trustee being removed as a choice. It should be borne in mind that it is widely accepted that the more "exotic" types of investments, those which have a real possibility of eroding a fund's asset base, are more likely to be found in SMSFs than SAFs.

Recommendations

1. The prudential supervision of TOWER Trust, as an Approved Trustee, remain with APRA but to create a level playing field between SAFs and SMSFs, in recognition of the many legislative and operational similarities between them, and to benefit from the existing annual return processing efficiencies associated with the prudential supervision of over 200,000 SMSFs, the prudential supervision of the 6,500 recorded SAFs pass to the ATO.

   Alternatively, the prudential supervision of SAFs remains with APRA but the administration duties associated with the regulation of SAFs (primarily the processing of 6,500 annual returns) pass to the ATO.

2. Either as an ATO regulated entity, or still within the APRA umbrella but with the administration duties associated with the regulation of SAFs now being undertaken by the ATO, SAFs be subject to the same return lodgment dates and levies that currently apply to SMSFs.

3. The prudential supervision of Approved Trustees remain with APRA, along with the existing requirement for Approved Trustees to provide APRA with a Prudential Management Certificate and copies of the financial statements of the APRA Approved Trustee within 4 months of the completion of the Approved Trustee's financial year.

4. That regardless of any of the above, the current supervisory levy charged to SAFs is inequitable in comparison to that charged to SMSFs or large pooled funds and any increase would exacerbate the matter.

OTHER MATTERS

The Requirement for a Trustee

TOWER Trust is firmly of the belief that the expertise, financial knowledge and ingrained prudential culture, established in some cases over more than one hundred years, of professional trustees, adds enourmous value to the process of assisting individuals to save for retirement within the superannuation environment.

We are aware that the Trustees Corporations' Association has submitted a paper on this issue and we fully support their view.

Investment Rules

TOWER Trust is of the opinion that the current investment rules embodied in SISA are fair and reasonable.

Our only comment relates to a proposal by the Government some time ago that superannuation monies be available for purposes of the fund member's housing. This is particularly evident in the types of private funds we deal with, where an individual would benefit by being able to borrow from the fund to repay a mortgage. In effect, the individual would then revert to paying interest to his or her superannuation fund, thereby increasing retirement funds, instead of to a commercial enterprise. The current restrictions on borrowing preclude such a strategy.

Attachment A

The legislative framework of funds with less than 5 members

SISA Sections 52(2)(f), 52(4), 58, 59, SIS Regulation 4.03, 4.04 and 4.09

Trustees of regulated superannuation funds with fewer than 5 members may be subject to direction and exercise of trustee discretion by a person other than the trustee. This enables members and unit holders of these funds to have direct input on investment decisions.

Trustees of regulated superannuation funds with fewer than 5 members are only bound by a direction from a member to purchase a specific investment where the governing rules permit the direction, the resulting investment is in accordance with the investment strategy for the fund and the investment does not conflict with SIS requirements.

For funds with more than 5 members, trustees may seek advice or use the services of others. However, the governing rules of the fund must not permit trustees to be subject, in the exercise of any of the trustee's powers, to direction in relation to investments by any person.