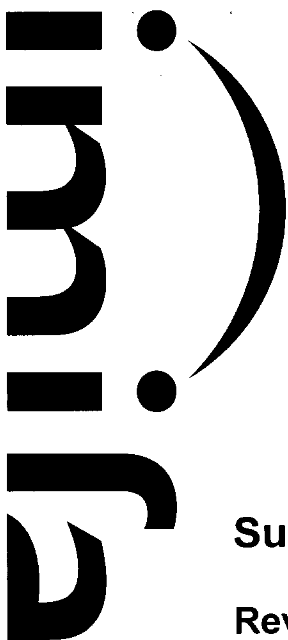

Head Office
Level 19
Casselden Place
2 Lonsdale Street
Melbourne
Postal Address
Locked Bag 999
Carlton South
VIC 3053

Tel: 03 9200 4555
Fax: 03 9200 4433
www.jmifa.com.au

Submission to the Productivity Commission

Review of the *Superannuation Industry (Supervision) Act 1993* and certain other Superannuation Legislation

Jacques Martin Industry Funds Administration Pty Ltd ("JMIFA") administers a number of industry superannuation funds, both public offer and non-public offer, comprising approximately three million member accounts.

3. General Issues

Objectives of the legislation

What are the principal benefits of the legislation? How can they be measured? Have past problems declined in significance since the introduction of the legislation?

The principal benefits of the legislation are that it: -

- ensures that the trustee is the single responsible entity;
- partially codifies the duties and obligations of the trustee; and
- affords the regulators with powers to penalise the trustee directly.

The major difficulty, in the absence of legislation, is that the only avenue generally available to the beneficiaries of a trust to ensure that the trust is administered correctly is through the Equity Division of the Supreme Court of the various States and Territories - an expensive proposition. Further to this, legislation is able to reflect the extent to which superannuation has moved from the classic trust law scenario, whereby a settlor simply settles a capital amount, to recognise the rights and obligations of the employer in present day superannuation.

The previous legislation, the *Occupational Superannuation Standards Act 1987* ("OSSA"), was enacted under the taxation power of the Commonwealth, and as such the only sanction available to the regulator, the Insurance and Superannuation Commission ("ISC"), was to revoke a fund's compliance status and thereby deny it concessional taxation treatment. As this detrimentally affected the quantum of members' benefits and, accordingly, was considered to be rather draconian this had the effect of rendering the ISC a somewhat "toothless tiger" with respect to recalcitrant trustees.

How well does the legislation accommodate technological and other market-driven changes, including product development? How well does the legislation cope with contemporary problems?

As the legislation is not overly prescriptive (with the possible exceptions of the Determination made under section 153 with respect to Key Features Statements and the successor funds rules) then, within the bounds of policy, it does tend to accommodate changes in product design. Perceived contemporary problems tend to lie more in the area of policy as opposed to the unduly prescriptive nature of the legislation.

Costs of the legislation

What are the costs of compliance and how significant are they? How substantial are the costs of government administration? Is there scope to reduce such direct costs?

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?

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

The costs of compliance fall into three main categories: -

- ensuring that the IT system captures, stores and correctly calculates all required data, including complying with specifications for reporting to government;
- establishing various practices and procedures to be adopted by staff to ensure compliance. These largely consist of checks which must be made and questions which must be asked of members at various points; and
- developing, maintaining and producing complying documentation.

While outside the scope of this review, it should be noted that most compliance costs are associated with meeting the requirements of the various taxation acts, and in particular those imposed under the surcharge legislation.

Accordingly, while there may be barriers to entry to new players in the superannuation industry, these would largely be imposed by the requirement to comply with the taxation legislation, as opposed to the legislation currently under review.

The major barrier to exit could be considered to be the requirements of the definition of "successor fund" under sub-regulation 1.03(1) of the *Superannuation Industry (Supervision) ("SIS") Regulations.* Inter alia, the definition requires that a successor fund "confers on the member equivalent rights to the rights that the member had under the original fund in respect of the benefits".

The extent to which a fund's benefit design and products confer "equivalent rights" has been the subject of considerable legal opinion and advice since SIS commenced. While considerable lobbying of both the ISC and APRA to clarify their interpretation has resulted in the production of a recent Circular, nevertheless difficulties remain with the application of this concept to different scenarios and suggest that a revisit of the underlying policy considerations may be warranted.

The types of funds which may be considered to be subject to more onerous requirements under the legislation would be Public Offer Funds and Defined Benefit Funds.

Public Offer Funds are subjected to more rigorous prudential requirements in that they can only "issue an interest" if their trustee is an "approved trustee". Approval of a trustee involves certain capital requirements and a consideration of the trustee's ability to perform the obligations of their role.

The only significant difference in the day-to-day operational requirements imposed on Public Offer Funds is that they must disclose information to a prospective individual member via means of a prescriptive Key Features Statement.

While Defined Benefit Funds are subjected to some slightly more onerous requirements under the legislation under review, this is inherent in the nature of the benefit design of the funds. Again, however, it should be noted that one of the most significant factors in the demise of defined benefit funds - the final "nail in the coffin" - is outside the scope of this review - the inordinate complexity of administering the surcharge legislation.

Alternative means of achieving the objectives of the legislation

Are there less costly ways of achieving the legislation's objectives?

Should the legislation be restructured such that the enabling Act is confined to guiding principles for regulators, with additional detail contained in regulations?

Could the legislation be less prescriptive by focussing more on its intended outcomes and less on the means of achieving them?

Is there scope for greater reliance on self-regulation, such as industry codes?

Generally, complying with the legislation does not impose unduly onerous obligations or excessive costs. The majority of the compliance costs emanate from complying with legislation which is outside the scope of this review - largely taxation legislation and in particular administering the surcharge.

Restructuring the legislation would probably not achieve a significant outcome. The "devil is in the detail" and it does not really make a great difference where that detail is sourced - whether it be in the enabling Act, the regulations made under that Act or indeed through regulatory administration of the legislation.

What may prove of greater assistance would be a clearer consideration and documentation of the policy considerations underlying the legislation. Ideally this should be reflected in the Explanatory Memorandum to the Act or Explanatory Statement to the Regulations in lieu of the current practice of simply re-stating the provisions with no "explanation" whatsoever.

While increased focus on the intended outcome of the legislation would be welcomed, making the legislation less prescriptive is likely to lead to increased uncertainty, which in turn results in an increase in the costs of compliance.

Given the nature of the finance industry, and superannuation in particular, there may be little scope to move away from at least partially addressing the means of achieving the objectives of the legislation. As the financial services industry is largely a retail market and that the majority of the population is perhaps not as well informed financially as they should be, there is considerable scope for confusion and misunderstanding amongst consumers.

Added to this the fact that superannuation is largely compulsory, and in fact represents deferred salary and wages for the majority of the population, there is a strong case for continuing to prescribe the means by which the industry should operate.

The superannuation industry is an extremely diverse one, with products being offered by a range of providers, from industry funds, public sector and corporate funds through to the more retail end of the market, including master trusts, individual polices and Retirement Savings Accounts offered by banks. Given this, self-regulation, such as an industry code, would be totally inappropriate.

Could an alternative regulatory approach, based, for example, on a managed investments or company governance structure, provide superannuation at lower cost while still maintaining appropriate safeguards?

It is difficult to visualise how an alternative regulatory approach would provide superannuation at lower cost. The most important question is whether an alternative regulatory regime would ensure that appropriate safeguards are put in place. Whatever form those safeguards assume, surely the costs should be approximately the same, and certainly the same order of magnitude?

4. Legislation -specific issues

Superannuation Industry (Supervision) Act 1993

Specific areas of comment

Trustee rules

Is it appropriate that the SIS Act focuses on trusts as the principal legal structure of superannuation funds? Could other legal structures for superannuation funds be contemplated — for example, incorporated financial institutions that are prudentially supervised under other legislation?

Are the duties and obligations imposed on trustees warranted or do they involve excessive costs?

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?

Are the requirements relating to trustee appointment and removal appropriate?

Trusts continue to remain the most appropriate legal structure for superannuation funds.

A member's interest in a superannuation fund represents a capital sum which is being held and invested over the medium to long term by a third party, where contributions to that sum are largely compulsory in nature and represents in effect deferred salary and wages. Accordingly, it is appropriate that the third party is subject to fiduciary duties and obligations with respect to their management of that capital sum.

There is a considerable body of case law on the nature and extent of the fiduciary duties owed by trustees to the beneficiaries of a trust and on the considerations which must be taken into account in making any decision with respect to the trust. These duties continue to be appropriate when dealing with members' superannuation monies.

By moving to an alternative legal structure for superannuation funds would serve to severely weaken the nature of the obligations owed by the fund to the member \ beneficiaries.

This does not obviate the need for prudential supervision of the industry in addition to the fiduciary duties imposed upon trustee.

The duties and obligations imposed on trustees generally do not involve excessive costs - they are simply safeguards designed to ensure that the interests of the member / beneficiary are protected.

The concept of equal representation, while an apparent anomaly given the theory of trust law, acknowledges the role of the employer in present day superannuation. It affords a balance between the interests of members and those of the employers who are contributing to the funds.

Compliance with the requirements for equal representation should not involve much in the way of additional costs.

The requirements with respect to the appointment and removal of trustees are not overly prescriptive and could be considered appropriate.

While trustees of Public Offer Funds should be subject to some form of licensing, for funds which are not Public Offer this would appear to be unduly onerous. The safeguards imposed by trust law and prudential supervision should be sufficient in these circumstances.

Rules governing operations

Which of the requirements governing the operations of superannuation funds (apart from those excluded from the Commission's inquiry) involve significant benefits or costs?

Could some relaxation of requirements on contributor status (such as those relating to age and employment) enable significant cost-savings?

Are the requirements to provide information to the regulators appropriate or unduly costly (especially for small APRA funds)? Is there consistency between these requirements and the requirements in other legislation, such as the Income Tax Assessment Act?

While the policy underlying a number of the operating standards is to protect the revenue or to give effect to retirement incomes policy, and most are generally not prudential in nature, a number do involve significant benefits to members. In particular, the requirements with respect to minimum benefits; member-protection; portability; assignments and charges; rights to accrued benefits and restrictions on loans and investments all serve to protect the interests of members.

The drafting of some of the provisions, however, is less than clear and a comprehensive review to identify the policy objectives underlying the legislation and to ascertain whether they are reflected clearly in the legislation as drafted, would not go amiss.

Certainly, relaxation of requirements on contributor status would enable considerable cost savings.

The requirements with respect to age, which are also reflected in the compulsory cashing conditions, have their antecedents in the tax act where regulation of superannuation commenced.

While these may prove a little difficult to relax, given the overriding imperative to protect the revenue, subsequent policy developments may facilitate the achievement of these policy objectives through means other than the contribution and payment standards under SIS. The introduction and development of measures such as the Reasonable Benefit Limits ("RBLs") and the continual refining of the assets and incomes tests for eligibility for income support benefits may provide methods through which this policy objective could be achieved.

The occupational nexus, however, has already been severely strained, if not indeed almost broken, by the introduction of spouse contributions in particular (and to a lesser extent the imminent creation of spouse accounts with the advent of the Family Law and Superannuation legislation). If there is concern with respect to the revenue then perhaps a minimum age could be introduced, say 16, and then any further concerns could be addressed by the RBLs.

The requirements to provide information to the regulators are appropriate and are not unduly costly, given that the regulators are meant to be prudentially supervising the industry. While there is not always consistency between the requirements of the legislation and the requirements in other legislation, these are often designed to meet different objectives.

Superannuation providers

Is this approach appropriate? Could the same objectives be attained if some kinds of providers were supervised instead under other prudential legislation, such as the Managed Investments Act?

Does the SIS Act result in competitive inequality between providers?

The current approach appears appropriate, as the focus is on the nature of the interest being protected as opposed to the form of the provider supplying it.

It is difficult to imagine whether the same objectives could be attained if differing providers were supervised under differing legislation.

While it is possible that prudential supervision of purely financial considerations, such as solvency, could be achieved through differing legislation, the SIS Act does serve to satisfy a number of other policy objectives. Accordingly, provisions which address these policy measures in SIS would either need to be replicated in the other legislation or, the application of similar provisions in the other legislation could lead to inequitable results.

One of the virtues of the SIS Act is that, as it focus on the product and not the provider, it does result in competitive equality between providers. All are faced with the same set of legislative provisions which are equally applicable to their superannuation products, irrespective of the nature of the provider of that product.

Does the exemption of some public sector superannuation schemes raise any issues for this review?

The exemption of some public sector superannuation schemes would raise issues for this review in circumstances where the public sector schemes were competing in the same market as other superannuation funds. Given that membership of a public sector scheme is generally only available to specified employees within the public sector, and indeed may be a condition of employment, any differences between the SIS Act and the legislation governing the scheme is more an issue with respect to industrial relations and equity.

What are the benefits and costs of this differentiated approach?

The three types of superannuation entities are distinctly different and warrant a differentiated approach - there is little in the way of unnecessary duplication. There is an argument, however, that Approved Deposit Funds are largely of historical benefit and that there may no longer be a need for them to be differentiated from superannuation funds.

Investment rules

Does the SIS legislation, particularly the application of its investment covenants and other investment restrictions, unduly restrict investment strategies, or the investment process, to the detriment of funds' members?

Are the investment provisions in total unduly complex? Could their objectives be better achieved by another approach?

The restrictions imposed by the SIS legislation are designed to protect the interests of members.

The investment covenants in SIS largely reflect the principles of sound investment practice and largely codify the maters to which a prudent trustee should have regard under general trust law, given the fiduciary duties of trustees when investing the property of the trust.

While the investment provisions may have become a little complex, this was largely in response to certain practices occurring within the industry.

The objectives underlying the investment provisions could be achieved by re-emphasising the requirement for investments to be made on an arm's length basis. Ignoring in-house assets, which do necessitate specific restrictions in order to safeguard members' interests, a close examination of most investments will probably reveal that adherence to the requirement for the investment to be conducted on an arms' length basis is probably sufficient.

Regulated superannuation service providers

What are the benefits and costs of the provisions relating to investment managers and custodians? How necessary are the provisions? Would a different regulatory framework be more effective?

The major benefits of the provisions relating to investment managers and custodians are those of affording protection to the trustees of funds.

Given the prudential risks associated with investment management and custodians these types of provisions are probably necessary.

A differing regulatory framework would probably only prove effective if it were to prudentially regulate investment managers and custodians directly.

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 can prove an efficient means of monitoring compliance with SIS objectives, to the extent that they rely upon the expertise and professionalism of external auditors. Audits by external bodies should certainly reduce the need for surveillance by the regulators, as they should be entitled to rely upon the results of such audits in formulating their risk analysis of the industry.

It is difficult to see how the Act's requirements for compliance and financial auditing could be made less costly. It is critical that a financial audit is performed annually, however, an argument could be made that compliance audits of non-public offer could be performed less regularly, say every three years. Actuarial investigations should probably still be performed every three years.

Are all of these requirements necessary and consistent? Is there scope for changes which would reduce costs and \ or improve consistency?

These differing requirements are meeting differing objectives, which is why they are not consistent. Given these differing objectives there is probably little scope for change.

Would the achievement of the overall aims of the SIS Act be enhanced if the legislation were extended to other key service providers – for example, to administrators?

No. The overall aim of the SIS Act is to establish and enforce the concept of the single responsible entity of the superannuation fund - the trustee. As such the trustee is ultimately responsible for the administration and management of the operations of the fund.

One of the key maxims under trust law is that, while a trustee may delegate specific functions, it cannot delegate the responsibility for those functions.

Accordingly, while specified functions are delegated to be performed by the administrator, the trustee remains ultimately responsible for compliance with the legislation. This in effect serves as an additional monitoring mechanism, as the administrator is answerable to the trustee as to its compliance with the legislation.

Administration and enforcement of the Act

Is the regulatory oversight of superannuation trusts cost effective? Are the roles and responsibilities of the three regulators clear and consistent? Do the arrangements result in any unnecessary regulatory overlap, duplication or uncertainty? Are there any regulatory 'gaps'? Is there scope for a reduction in the regulators' costs?

The regulatory oversight of superannuation trusts is not as cost effective as it could be.

While the roles and responsibilities of the three regulators are relatively clearly defined and consistent, there are issues which emanate from their being more than one regulator administering the same legislation, albeit different provisions. As the SIS legislation was conceived and drafted as one piece of legislation there are often common concepts, if not defined terms, in differing parts of the legislative regime.

The arrangements can result in uncertainty when two or more regulators have developed a position with respect to a particular concept which, while it may fall clearly within the province of the provisions which they are administering, may touch upon a provision administered by another regulator. Further, the fact that ASIC in particular has inherited parts of legislation which was formerly administered by another regulator means that they have not had the advantage of developing their own position over time in the context of the overall legislation.

There do not appear to be any significant regulatory "gaps".

The major scope for reducing the regulators' costs would emanate from improved co-operation and communication between the regulators, including shared intelligence and possibly participating in joint surveillances.

Do the discretionary powers of the regulators facilitate compliance with the objectives of the legislation? How does material published by the regulators (eg APRA circulars) affect the costs of funds' compliance?

The discretionary powers of the regulators do facilitate compliance with the objectives of the legislation, as it allows the regulator to focus on issues of importance.

Material published by the regulators can reduce the costs of compliance by increasing certainty and obviating the need for independent legal advice, provided it is clearly considered and does not reverse a previously settled position or fly in the face of accepted industry best practice. It is especially useful when the regulator does not have direct input into the legislative processes.

How effective have these powers been in protecting members' interests? Are the powers excessive?

Are the costs (to regulators and funds) of monitoring undertaken by regulators warranted?

These powers could prove effective in protecting members' interests in cases where they are suspected of being at risk. The powers as granted by Parliament do not appear to be unduly excessive, although like any similar powers they are capable of being abused.

The costs of monitoring undertaken by regulators are warranted, given the risks that they are seeking to protect against.

Do the penalty provisions provide appropriate incentives for compliance?

As the previous sanctions under OSSA were loss of complying status, which was unlikely to be invoked, penalty provisions do provide a more appropriate incentive for compliance. Similarly, as the fault liability provisions under SIS required proof of an "intentional or reckless" contravention, the move to strict liability provides an even greater incentive.

Superannuation (Resolutions of Complaints) Act

What are the advantages and disadvantages of a statutory body relative to other dispute resolution mechanisms, such as a financial industry disputes resolution body?

The advantages of a statutory body relative to other dispute resolution mechanisms is its independence - both perceived and real.

How cost-effective has the Tribunal been in resolving complaints? Should a charge be levied on complaints brought to the Tribunal? If so, in what circumstances and how would it be determined?

The Tribunal appears to have been relatively cost effective in resolving complaints.

As the Tribunal has the power to treat as withdrawn complaints which it thinks are trivial, vexatious, misconceived or lacking in substance there does not appear to be compelling reason to levy a charge on complaints brought to the Tribunal.

Superannuation (Financial Assistance Funding) Levy Act

Is it appropriate to make provision for such a levy? Would a legislative requirement that funds contribute to an emergency reserve (fidelity fund) be an alternative?

It may be appropriate to make provision for such a levy. The legislative requirement that funds contribute to an emergency reserve would prove unpopular - perhaps part of the annual supervisory levy could finance premiums to an off shore re-insurer.

Superannuation (Self Managed Superannuation Funds) Taxation Act and Supervisory Levy Imposition Act

To what extent is the purpose to which the levy is put beneficial to self-managed superannuation funds?

Given the nature of self-managed superannuation funds, it is arguable whether the purpose to which the levy is put is beneficial to self-managed superannuation funds. It should be borne in mind, however, that as a superannuation fund they are entitled to significant concessional tax treatment.

Does the amount of the levy appropriately reflect the ATO's cost of supervising self managed funds?

Whether or not the amount appropriately reflects the ATO's cost of supervising self-managed funds, from a fund's perspective it is a relatively small amount in comparison with the amounts saved through concessional tax treatment.

Occupational Superannuation Standards Regulations Application Act

Does administration of this Act involve unnecessary administration costs? Would it be appropriate to terminate these provisions?

It is not readily apparent how many funds existing before 1 July 1994 would not have yet elected to be regulated. Any administration costs incurred by APRA would obviously reflect the number, if any, of funds which are in this class. If there are few then consideration should probably be given to terminating these provisions.