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Mr John Cosgrove
Presiding Commissioner
Review of Superannuation Legislation
Productivity Commission
PO Box 80
BELCONNEN ACT 2616

Dear Mr Cosgrove

REVIEW OF SUPERANNUATION LEGISLATION

The Investment & Financial Services Association represents Australia's leading investment managers and life insurance companies. Our 70 members hold more than $600 billion in assets under management on behalf of nine million Australians who have superannuation and managed funds.

The basic premise of IFSA's submission on the duplication of regulation and compliance effort in the retail funds management industry was outlined at the public hearings on 16 May. This written submission provides examples of that duplication. This submission also offers IFSA comments on the question of whether the prudential regulator should also be charged with supervision of retirement incomes policy aspects of superannuation regulation.

The terms of reference for this review exclude the major policy content of superannuation, such as the level of compulsory superannuation contributions. Accordingly, we have concentrated our comments on the general regulatory scheme.

Duplication between Superannuation and Managed Investments Regulation

IFSA member companies currently must run two concurrent regimes over the same basic investment funds – the Managed Investments Act (MIA) – which forms Chapter

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5C of the Corporations Law (CL) - for ordinary retail investments, and the Superannuation Industry (Supervision) Act (SIS) for retail superannuation investments.

The MIA scheme is an effective prudential regime. In terms of the provisions governing operation of the entity responsible for the investment offering, the MIA covers much of the same ground and gives consumers at least the same level of protection as SIS. In particular, the MIA provisions mean that a responsible entity is effectively a trust (see below).

Retail investment fund managers must run both schemes concurrently to offer products in the retail 'ordinary money' and retail superannuation markets. In investment terms, these products are similar or indistinguishable. Differences lie in taxation and superannuation policy provisions rather than the underlying investments.

As a result, there is duplication or overlap in the operational and compliance regimes for retail investments. The retail provider has to be both a single responsible entity (with associated reporting and compliance regime) for MIA, as well as an Approved Trustee (with that associated reporting and compliance regime) for SIS. Most obviously, retial providers must go through two establishment and approval processes, and must run two compliance schemes. As but one detailed example, there are similar but different requirements for custodians, which retail providers must reflect in agreements.

Trust structures

To be a regulated superannuation fund under SIS, a fund need not be a trust and there need not be a trustee (see section 19 and the definitions of "superannuation fund" and "trustee" in section 10). Nevertheless:

(a) the trustee of a public offer entity must not engage in certain conduct unless the trustee is an approved trustee and the entity is constituted by a deed as a trust (section 152(2));

(b) a number of trust law duties are codified by section 52 of SIS and imposed on trustees of superannuation entities (see 2 below); and

(c) certain application money received by a trustee of a public offer entity must be held on trust (section 168).

The definition of "managed investment scheme" (see section 9 of CL) does not require a managed investment scheme to be a trust. Nevertheless:

(a) the responsible entity holds scheme property on trust for scheme members (section 601FC(2));

(b) a number of trust law duties are codified by section 601FC(1) and imposed on responsible entities (see 2 below);

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(c) certain application money received by responsible entities must be held on trust (section 722 and 867);

(d) in our experience the vast majority of schemes are set up as unit trusts so that they gain the benefit of look through income tax treatment.

Codified trustee duties

The following table contrasts the duties imposed by section 52(2) of SIS and section 601FC(1) of CL.

	Section 52(2) of SIS	Section 601FC(1) of CL
1	The standard of care, skill and diligence is that which an "ordinary prudent person would exercise in dealing with the property of another for whom the person felt morally bound to provide".	The standard of care and diligence is that which a "reasonable person would exercise if they were in the responsible entity's position".
2	The trustee must act honestly in all matters concerning the entity.	The responsible entity must act honestly.
3	The trustee must ensure its duties and powers are performed and exercised in the best interests of the beneficiaries.	The responsible entity must, in exercising its powers and carrying out its duties, act in the best interests of members. If there is a conflict between the members' interests and its own interests, it must give priority to the members' interests.
4	The trustee must formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the entity including four specific matters.	No equivalent section 601FC duty. However, section 708 of the CL would usually require the investment objective and strategy to be specified in the prospectus and so it is disclosed to investors prior to the issue of interests.
5	No equivalent SIS duty.	The responsible entity must ensure that scheme property is valued regularly.
6	The trustee has a duty not to enter into any contract, or do anything else, that would prevent the trustee from, or hinder the trustee in, properly performing or exercising the trustee's functions and powers.	No equivalent CL duty.

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7	No equivalent section 52 duty. However, sections 58 to 60 of SIS set out certain requirements in relation to the governing rules of the Fund and their amendment.	The responsible entity must ensure that the scheme's constitution meets the CL requirements and carry out or comply with any duty conferred by the constitution.
8	No equivalent SIS duty.	The responsible entity must ensure that the scheme's compliance plan meets the CL requirements and comply with the compliance plan.
9	No equivalent SIS duty.	The responsible entity may not make use of information acquired through being the responsible entity in order to: • gain an improper advantage for itself or for another person; or • cause detriment to the members of the scheme.
10	If there are any reserves of the entity the trustee must formulate and to give effect to a strategy for their prudential management.	No equivalent CL duty, although it is unusual for a scheme to have reserves.
11	The trustee must allow a beneficiary access to any prescribed information or any prescribed documents.	No equivalent section 601FC duty. The responsible entity is required, under section 111AF and Part 6D, to lodge documents with the Australian Securities and Investments Commission ("**ASIC**") that are available for public access (such as the constitution of the scheme).
12	The trustee must keep the money and other assets of the entity separate from any money and assets, respectively: • that are held by the trustee personally; or • that are money or assets of a standard employer-sponsor, or an associate of a standard employer-sponsor, of the entity.	The responsible entity must ensure that scheme property is held separately from the property of the responsible entity and property of any other scheme subject to some limited exceptions.
13	No equivalent SIS duty.	The responsible entity must ensure all payments out of the scheme property are made in accordance with the scheme's constitution and

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		the CL.
14	No equivalent SIS duty.	The responsible entity must report to ASIC any breach of the CL that relates to the scheme or has had, or is likely to have, a materially adverse effect on the interests of the members.

The above table shows how a responsible entity's duties are similar to and, in some cases, more extensive than a trustee's duties under SIS. For example

(a) in example 1, the prudent person duties would, for a professional responsible entity, impose a higher duty on the responsible entity then the duty imposed on the trustee of a superannuation entity;

(b) in example 2, the duty to act in the best interests goes one step further for responsible entities by expressly requiring them to "*give priority to members' interests*";

(c) in examples 7 and 8, the responsible entity must ensure that the scheme complies with its constitution and compliance plan, and that the constitution and compliance plan comply with the CL (discussed in 3 below);

(d) in example 14, the responsible entity has a positive duty to report to the regulator in certain circumstances (discussed in 4 below).

Despite the similarities between section 52(2) of SIS and section 601FC(1) of CL, the consequences of contravention are not equivalent. Whilst a contravention of either section 52(2) of SIS or section 601FC(1) of CL may give rise to a civil action for loss or damage (see section 55(3) of SIS and section 1317H of CL), SIS does not contain equivalent civil penalty provisions. In particular:

(a) a contravention of a section 52 duty is not an offence (section 55(2)) and section 52 is not a civil penalty provision; but

(b) section 601FC of CL is a civil penalty provision and Part 9.4B of CL provides the consequences of contravening include:

i. a pecuniary penalty order of up to $200,000 (section 1317G); and

ii. a disqualification order under section 206C.

Compliance Plans and Committees

The CL provides a more comprehensive compliance regime for registered schemes than SIS does for public offer entities.

One of the duties of the responsible entity is to comply with the scheme's compliance plan (section 601FC(1)(h)). The consequences of not complying with section 601FC

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are outlined in 2.3 above. A scheme's compliance plan must set out adequate measures that the responsible entity is to apply in operating the scheme to ensure compliance with the CL and the scheme's constitution (section 601HA). The plan must be lodged with the ASIC and must be audited.

SIS does not expressly require the trustee of a superannuation entity to have such a compliance plan, let alone prescribe its contents and require it to be audited. The closest SIS comes is in the instruments of approvals for approved trustees (ie trustees of public offer entities). A common condition is that the trustee must within four months of the end of each financial year provide a prudential management certificate. The certificate must state that, among other things, the trustee's board has made an assessment of various risks and has systems in place to manage those risks.

If less than half of the directors of the responsible entity of a registered scheme are external directors, a compliance committee must be established (section 601JA). The majority of compliance committee members must be external. SIS does not require external directors or compliance committees. The trustee of a standard employer-sponsored public offer superannuation fund must be an independent trustee but what is an "independent trustee" is based on independence from members rather than the trustee itself.

Reporting breaches of the law and licences to regulators

The responsible entity must:

(a) report to ASIC any breach of the CL which relates to the scheme and that has (or is likely to have) a materially adverse effect on the interest of members as soon as practicable after it becomes aware of the breach - there is no equivalent under SIS; and

(b) notify ASIC within one day after contravening a condition of its dealers licence - whereas an approved trustee has 30 days to notify the Australian Prudential Regulation Authority of a contravention after becoming aware of a contravention of a condition of approval (note there is no similar requirement for trustees which are not approved trustees under SIS).

Ground which is not common

In addition to the areas noted above, SIS regulates a number of activities which are not regulated by the CL for registered schemes. These provisions may be directly related to retirement incomes policy, such as the contribution and preservation rules, or could be seen as prudential, such as the restriction on borrowing. Examples include:

(a) trustees must ensure that the fund is maintained for a sole purpose (section 62);

(b) operating standards of the fund

i. who may contribute; and

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ii. preservation of benefits (section 31(2)).

(c) Restriction on borrowing for superannuation entities.

Similarly, the CL also regulates other activities of registered schemes not covered by SIS. For example:

(a) members may remove the responsible entity of the scheme (section 601FM);

(b) prohibitions on investment in unregistered managed investment schemes, subject to relief in certain circumstances (see section 601FC(4));

(c) liability for agents (section 601FB(2)).

Suggested solution for retail superannuation

The duplication, which arises from the dual coverage from SIS and MIA provisions over what are otherwise the same managed investments, could be avoided if retail investment fund managers were able to register and comply with one scheme, and have this carry across to the other environment. IFSA members have generally indicated a preference for the MIA scheme over SIS in this regard, on the basis that the MIA has clear and codified responsibilities and compliance processes. (IFSA outline this at the hearing, and can provide further information if required.)

IFSA suggests such an arrangement could readily be implemented through a provision which had the effect that a responsible entity (with an appropriate licence) is to be regarded as having met the obligations of those SIS provisions which cover approved trustees. In other words, compliance with MIA and licence conditions would be taken as compliance with the relevant SIS provisions. Further, this arrangement could be a voluntary one, so that superannuation funds that do not experience the problem of duplication could remain regulated as they are now.

This proposed arrangement would not introduce more regulators than are currently involved in superannuation. Under existing arrangements, The Australian Securities and Investments Commission is already involved in superannuation regulation, are both the Australian Taxation Office (ATO) and the Australian Prudential Regulation Authority (APRA). Given that the ASIC already has responsibility for managed investment schemes, this change would represent a rationalisation of regulatory effort.

Policy Regulation by the Prudential regulator

IFSA member companies have experienced some confusion and perhaps duplication in the current assignment of responsibility for superannuation regulation.

Of particular note is that the APRA is generally charged with the prudential regulation of superannuation, yet administers provisions which are not prudential. For example, the APRA appears to have principal carriage of SIS regulations covering contributions (Regulation 7.04, among others) – when these can be accepted, and so on. These provisions flow directly from the retirement incomes policy objectives, and aim to

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limit access to the concessional taxation environment to genuine retirement savings. They also operate to limit the opportunity for tax deferral through the superannuation system. As such, they are taxation policy, rather than prudential, provisions and arguably could be better administered by the taxation regulator.

A number of similar situations exist, such as the APRA administering SIS rules about the monitoring on employment status for superannuation fund members aged over 65.

The ATO already has carriage of superannuation regulation as it relates to self-managed-superannuation funds. Locating the administration of all superannuation policy regulation with the ATO would result in a single regulator having carriage of all retirement incomes policy provisions of superannuation regulation. This would avoid possible differences in approach as well as giving at least some efficiency benefits through the removal of duplication.

Yours sincerely

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