WILLIAM M.
MERCER

4 May 2001

Review of Certain Superannuation Legislation
Productivity Commission
PO Box 80
BELCONNEN ACT 2616

Dear Sir,

Review of the Superannuation Industry (Supervision) Act 1993

Mercer is a leader in the provision of administration, actuarial and consulting services to superannuation funds. We concentrate on providing such services to corporate superannuation funds, in particular for many of Australia's leading employers. We also operate the Mercer Retirement Trust, a master trust with assets currently in excess of $2 billion and a significant financial planning service for individuals.

We welcome the opportunity to submit our comments on the Review of the Superannuation Industry (Supervision) Act 1993. In our role as administrator and adviser to superannuation funds we are vitally interested in increasing efficiency in the industry.

Our submission is attached and has been set out as follows:

- **Section 1:** Barriers preventing superannuation funds competing against other financial sector providers
- **Section 2:** Barriers preventing superannuation funds competing against other superannuation funds
- **Section 3:** Barriers restricting access to work in the superannuation industry to actuaries/auditors etc
- **Section 4:** Responses to some of the specific questions raised in the Commission's Issues Paper
- **Appendix:** Details of specific issues where improvements can be made to increase productivity.

We look forward to discussing our submission with the Commission. Please contact me on 03 9245 5552 if you have any queries.

Yours Sincerely

Belinda Dean

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**SUBMISSION TO PRODUCTIVITY COMMISSION
ON
REVIEW OF THE SUPERANNUATION INDUSTRY (SUPERVISION) ACT
1993
AND
CERTAIN OTHER LEGISLATION
BY
WILLIAM M MERCER PTY LTD
May 2001**

Section 1: Barriers preventing superannuation funds competing against other financial sector providers

Superannuation funds face many restrictions that are not faced by other financial sector providers. On the other hand there are some advantages available to superannuation funds that are not available to other providers.

Examples of restrictions

- Benefits are locked in (preserved) with payment of benefits generally restricted to payment at retirement, death or permanent incapacity.
- Funds are restricted in the benefits that can be provided (sole purpose test).
- Funds must comply with an extremely long and detailed list of legislative requirements.
- The complexity of the taxation system applying to superannuation which confuses members and leads to distrust of the system.

Examples of advantages

- Concessional tax treatment (although the combination of the tax on contributions, surcharge, the tax on investment income and the taxes on benefits can sometimes result in superannuation being more harshly treated than other investments or salary income).
- Employers' Superannuation Guarantee contributions must be made to a complying superannuation fund, providing a compulsory cash flow to superannuation.

Comment

It is clear that superannuation has a special place in the investment community. It is designed to provide benefits in the period after retirement and should result in significant reductions in future Social Security costs.

As such it is appropriate that there are requirements that benefits be preserved and that Superannuation Guarantee contributions be made to such a system. To provide an offset for the very restrictive preservation requirements, it is appropriate that tax concessions be offered. Tax concessions are also justified due to the future savings in Social Security.

The complexity of the superannuation tax system and the adequacy of the tax concessions are not within the scope of this enquiry. However we need to mention:

- The huge costs being incurred by superannuation funds trying to administer the superannuation surcharge;
- The ongoing costs incurred by superannuation funds in explaining the tax system to members and calculating tax on benefits; and
- Disincentives to accumulate significant superannuation balances in excess of the SG for those who might otherwise qualify for the means tested government pensions.

These tax issues seriously impede superannuation funds from operating efficiently. Surcharge in particular results in far greater compliance costs than any other aspect of superannuation.

The efficiency of superannuation funds (and hence their ability to compete against other types of financial product) could be improved significantly by simplification of the voluminous SIS Act, its associated Regulations, and Circulars issued by Regulators.

Simplification and reduction of the requirements would also enable trustees to concentrate on far more vital issues such as maximising investment returns and the security of members' benefits. This would also enable the Regulators to concentrate on these vital issues rather than trying to ensure that trustees meet a large number of seemingly minor requirements.

The Sole Purpose Test also places restrictions on the type of benefits that can be offered. Provision of ancillary benefits such as financial planning advice, access to home loans, sickness and disability income benefits should be encouraged by amendments to the Sole Purpose Test.

Section 2: Barriers preventing superannuation funds competing against other superannuation funds

The number of corporate funds of more than 4 members has reduced from 5833 in June 1995 to 2065 in September 2000. This reduction in the number of funds has resulted from the winding-up of many corporate superannuation funds. This has occurred for a number of reasons:

- A general outsourcing by employers of non-core activities.
- A reduced perception amongst employers that a corporate superannuation fund has a favourable impact in attracting and retaining staff.
- The significant increases in cost (both dollars and employees' time) involved with running a superannuation fund.

The general outsourcing issue is difficult to combat and the perception of superannuation as a recruitment tool was always likely to decrease with the advent of compulsory superannuation.

However, the large costs involved in running a superannuation fund will continue to result in a decline in the number of corporate funds with virtually no new funds being established in this sector.

The demise of corporate funds which are generally run on a non-profit basis and often heavily subsidised by employers, will result in many employees participating in master trusts or higher cost retail funds (or potentially more risky self managed funds).

The increase in legislative requirements in the last 10 years has also hit defined benefit funds far harder than accumulation funds. In new legislation, defined benefits funds are often an afterthought with such funds being required to comply with extremely complex and unsuitable requirements.

There are also barriers facing pensioners who wish to change funds because they are unhappy with the investment performance or the service provided by the existing fund. It should be easy to transfer that pension benefit from one fund to another. However Tax Office practice in the administration of Reasonable Benefit Limits means such a transfer can result in a pension previously assessed as within the RBLs being reclassified as partly an excess benefit resulting in partial loss of the pension rebate. Tax Office practice should be returned to that applicable prior to 1994 under which it was recognised that all a person in this situation had done was to change funds-there has been no change to the pension-so there should be no basis for a new RBL assessment.

Section 3: Barriers restricting access to work in the superannuation industry to actuaries/auditors, etc

In our view, there are limited aspects of the SIS legislation where particular professions are given a "monopoly" position. In the main these aspects all appear to be in place for good reason.

The legislation requires the involvement of actuaries in the following areas:

For defined benefit funds:
- Conducting actuarial valuations and Funding and Solvency Certificates.
- Certification of the level of "special in-house assets".
- Certification of ability to return surplus to an employer sponsor.
- Determination of pre July 1988 Funding Credits.

For accumulation funds:
- Certification of ability to return surplus to an employer sponsor.
- Designing programs to return a technically insolvent fund to a solvent position.
- Recommending an alternative course of action for a fund that would otherwise need to be wound up due to the technical insolvency rules.

In regard to the actuarial requirements for defined benefit funds, actuaries are specifically trained to perform these tasks. Actuaries' expertise in projections of future experience, discounted cash flow techniques, analysis of mortality etc, makes the actuarial profession ideal for the performance of these tasks. It is unlikely that members of any other profession could perform these functions. Furthermore, given the decline in defined benefit funds the demand for these services is likely to fall leading to increased competition amongst actuaries for the remaining business.

Actuaries are also ideally placed to perform the tasks listed for accumulation funds. However, we concede that these tasks could also be performed by many in the accounting/auditing professions. We point out however that the number of occurrences where actuarial involvement in an accumulation fund will be required is likely to be small. A properly managed fund should not become technically insolvent in the first place and few accumulation funds have surplus available to return to employers.

In regard to the "monopoly roles" given to auditors, these are largely restricted to the auditing of annual financial statements and the issue of the auditor's report. The involvement of auditors in such tasks would seem to be logical.

Section 4: Responses To Some Of The Specific Questions In The Productivity Commission's Issues Paper

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 benefit **should be** to provide a secure system for peoples' retirement savings.

Prior to the introduction of Superannuation Guarantee (SG), many employees received little or no benefit from superannuation. Some employers used the system purely for tax benefits. The introduction of SG changed that significantly. However, there has never been a significant level of superannuation fund failure in Australia. It is therefore difficult to determine how well the legislation has succeeded in providing a secure system.

Recent episodes such as the Commercial Nominees case indicate that the legislation has not been totally successful. Whether or not it has been more successful than previous legislation would have been in the same circumstances will never be known.

The introduction of member appointed trustees appears to have introduced greater accountability to members but often at the cost of appointing less experienced trustees.

Our main concern is that the legislation concentrates far too much on minor issues. Trustees, administrators and the Regulator are all forced to devote so much time to ensuring compliance with voluminous legislation that there is little time left for the major issues of maximising investment returns and security.

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

The legislation needs to be far more flexible in allowing electronic rather than paper based reporting to members. We note that some of these issues may be addressed once the Financial Sector Reform Bill is enacted.

What are the costs of compliance?

It is probably impossible to isolate the compliance costs. Compliance effectively impacts on every transaction in some way or other. Whilst compliance with SIS is a significant issue, compliance for tax purposes is even more significant. By far the greatest compliance issue is the superannuation surcharge. Nevertheless, there are still significant issues in SIS which need addressing in order to improve efficiency.

Does the legislation restrict competition in any aspect of the superannuation industry?

This was covered on more detail in Section 2 of our submission. In particular:

- The significant compliance costs have been a significant driver in the reduction of the number of corporate superannuation funds.
- Defined benefit funds (particularly those providing certain pension benefits) are subject to more onerous requirements than other funds.
- There are barriers to transferring a pension from one fund to another.

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

Yes. Some of the main areas of complexity are set out in the Appendix to our submission.

One of the major issues in regard to the legislation is that often there has been a lack of proper consultation with the industry prior to enacting legislation or Regulations. Even when there is consultation, many of the concerns raised by industry are not properly addressed.

This results in legislation that is totally unclear or can be interpreted in many different ways. A recent example was the introduction of increased preservation requirements in 1999. Despite representations to both the Government and APRA that the proposed wording covering the treatment of defined benefit funds was not capable of being interpreted, the amendments were introduced without change. APRA later advised us that it did not know what the particular Regulation meant. It was left to trustees and their advisers to guess what was intended.

It also appears some parts of SIS are attempting to accommodate the often conflicting desires of various Government Departments. This can result in inappropriate and inefficient legislation that increases costs and results in considerable confusion (eg Modification Declaration 23).

Another example is that the requirements for a complying pension set out in the SIS regulations are slightly different to those set out in Social Security legislation for assets test exemption. In addition we now have the situation where action by trustees to comply with APRA requirements regarding the assets a fund must have available to enable an actuary to issue a positive certificate in relation to pension benefits (Modification Declaration 23) can result in Social Security deeming that a deprivation of assets has occurred so that age pension entitlement is reduced for the next 5 years.

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

A reduction in the volume of legislation would certainly help. In our view, less prescriptive legislation focussing more on its intended outcomes and less on the means of achieving them may be one way of doing this. However it would also require that the Regulators apply a consistent and practical approach in setting guidelines and enforcement policy.

We also believe that a significantly different approach will result in considerable costs in coming to grips with new legislation. Significant ongoing cost savings would need to be justified in order to offset these initial costs. Trustees and superannuation fund members are looking for stability. There has been too much change already. We believe a more appropriate approach would be to continue to operate under the current system but to simplify and improve those aspects that are currently causing significant inefficiencies.

Is it appropriate that the SIS Act focuses on trusts as the principal legal structure of superannuation funds?

The trust structure has generally worked well for many years. It is particularly appropriate for corporate funds. Any change in the required structure is likely to result in a major upheaval and we do not believe that such a change is warranted at this time.

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 superannuation funds deliver significant benefits? Does compliance with it involve any unnecessary costs? Are the requirements relating to trustee appointment and removal appropriate? Should all trustees be subject to some licensing regime?

In our view, equal representation is, at least in theory, an appropriate method of ensuring member involvement in the decision making process. However, by establishing this system, many trustees are inexperienced in the trustee role. Appropriate trustee training is necessary, however it must be remembered that many trustees are ordinary workers with no significant financial skills.

In the Appendix we have commented specifically that we consider APRA's requirements for filling casual vacancies to be overly prescriptive and costly.

The Financial Sector Reform Bill (FSRB), if enacted, will require greater licensing. It is clear that many existing trustees will never be able to attain the qualifications needed to become licensed. The ability to outsource those aspects of the trustees' role to an appropriate licensed body (as seemingly allowed by the FSRB) will be essential.

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

In the Appendix, we have set out details of those requirements which we believe involve unnecessary costs.

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

These aspects currently cause significant compliance costs with no significant benefits being apparent. This is one area where simple changes could be made to the Regulations and reduce costs. We have commented in more detail in Items 2 and 3 of the Appendix.

At the very least the conditions applying under age 65 should be extended to persons aged 65 to 70. We consider Government policy should encourage people who can to work after age 65 and facilitate rather than complicate part time or irregular work by those in this age group.

Are the requirements to provide information to the Regulators appropriate or unduly costly?

We have commented in Item 1 in the Appendix of our concern regarding the timing requirements for APRA annual returns.

We also question the value of funds being required to provide statistical information on a regular basis. We would suggest that any statistical information only be collected in conjunction with annual returns and that the information requested be limited.

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

In general, we consider the investment rules to be reasonable. We agree that there should be restrictions on the level of "in-house" assets although the legislative detail is too complicated.

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?

Due to the extremely large number of compliance issues that need to be covered in an audit, they involve considerable cost. The aim of an audit should be to verify and improve the security of member's benefits. However, many of the compliance issues are not related to benefit security but relate solely to checking whether obscure and often unimportant legislative requirements have been complied with. We believe that compliance audits can become far more effective if the emphasis of the legislation was changed (ie remove many of the current compliance requirements) so that the audit can concentrate on more important issues. This would reduce costs and produce more effective outcomes.

Are all of the different requirements in the SIS Act and the Income Tax Assessment Act relating to actuarial certificates necessary and consistent?

The requirements are certainly not consistent and we consider some of them unnecessary. In particular there are 5 different legislative methods adopted for various purposes of placing a value on a pension. We have commented further in the Appendix but have particular concerns with Modification Declaration 23 and also believe that the provisions in relation to Funding and Solvency Certificates need to be overhauled. Items 5 and 6 of Appendix.)

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?

As a major administrator of corporate superannuation funds, we see no significant advantages in such a proposal however we would be happy to comment on any specific proposals. It is likely that such an extension could involve another layer of unnecessary compliance.

Administrators are generally operating a business designed to produce a profit. Competition in the industry has been high, ensuring prices are competitive. Non-performance by an administrator can result in loss of a client or non-performance penalties under a service contract being invoked. In other cases they may be liable for errors etc. As such, there are already many commercial pressures on administrators to provide an appropriate service.

Often, administrative delays or errors occur, not because of delays or mistakes by the administrator but due to incorrect or misleading information provided (in almost all cases innocently) by the trustee or employer. The administrator needs to work with the client to address such issues.

In general we believe that it is the client superannuation fund that should be responsible for monitoring the performance of the administrator rather than the Regulator.

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?

Again we consider that the detailed requirements in the legislation require the Regulators to spend too much time on minor compliance issues. Their role could be far more effective if the compliance requirements were reduced and simplified.

It is not always clear to the industry where the boundaries between the Regulators' roles lie. There are also occasions where conflicting responses have been obtained from differing Regulators. Generally these can be clarified, however more cost has been incurred to obtain the clarification. These issues generally relate to overly complex or unclear aspects of the legislation.

It is also difficult in some situations to determine why a particular requirement exists. For example, was Modification Declaration 23 introduced to:

- increase the security of pension funds (a possible aim of APRA);
- limit the ability of small funds to provide pension benefits (a possible aim of the ATO);
- Limit the asset test exemption for pensions (a possible aim of Dfacs).

All three Departments have had input on this Declaration, and all appear to be coming from a different direction. Further detail is included in Item 6 of the Appendix.

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?

In most cases, the circulars and other material are helpful rather than an additional cost – other than there are hundreds more pages of material that trustees and administrators are expected to know. However if the legislation had been clearly drafted in the first place, some of these circulars would have been unnecessary. Instead the circulars could have concentrated more on considering the principals involved and how they can be adapted to unusual situations.

Nevertheless, there are some instances where we believe that the circulars are either clearly inconsistent with the underlying legislation (refer Appendix) or have adopted an interpretation of the legislation that seems to involve a greater compliance requirement than that implied by the less precise legislation.

How effective have the SIS Act's strong surveillance and enforcement powers been in protecting member's interests? Are the powers excessive?

Whilst there is no evidence to support this, we have doubts that these powers have added significantly to the protection of member's interests. The establishment of superannuation funds under a trust structure has provided protection and the equal representation requirement has also helped in this regard. The Superannuation Complaints Tribunal has also played a part. We expect that these issues have played a much larger role in protecting members' interests than the surveillance and enforcement powers of SIS.

We note that, due to the complexities of superannuation, many members do not know their rights and are therefore often unable to ensure that their own interests are protected. That there have been so few cases of superannuation fund failures (both before and after SIS) indicates that the system is basically working.

Do the penalty provisions provide appropriate incentives for compliance?

We do not believe that all of the penalty provisions (particularly the strict penalties) are appropriate for a system relying on an equal representation of member and employer trustees. We believe that the current penalty system is likely to:

- further encourage corporate funds to wind up, or
- discourage appropriately qualified members from seeking election as a trustee.

It is rare that a trustee of a corporate superannuation fund deliberately breaches a compliance requirement. Breaches generally arise because of:

- unwitting errors (in many cases the trustee will believe that there has been no breach),
- the time period allowed by the legislation is too brief in the particular circumstances.

In general, the monetary penalties will also penalise the members. (This will either be because of the penalty itself being met from the fund's assets or higher trustee indemnity insurance premiums.) It seems illogical for a Regulator set up to protect members' interests to effectively penalise those members by imposing penalties for errors over which the members had no control.

APPENDIX: LEGISLATION THAT UNNECESSARILY IMPACTS ON COSTS

There are many aspects of superannuation legislation that impose unnecessary costs on superannuation funds. Many of these aspects are included in tax legislation (in particular the superannuation surcharge) and are not covered here. The aspects below are issues in SIS.

1. Lodgment of annual returns

In 2000, the timing requirement for non-public offer funds to lodge annual returns to APRA was reduced from 6 months to 4 months. Such a change in a year when funds were also struggling to cope with major changes to the taxation system was inappropriate.
However, this change will also have a longer term impact on costs and should be reviewed. Most superannuation funds have a 30 June balance date. In order to submit the annual return, it is necessary for the fund's financial statements and tax figures to have been completed. Because of the weighting of 30 June balance dates, those involved in the administration, accounting and auditing of funds have a peak working load in the 4 months following 30 June. This is also the period in which accounting and audit firms are also trying to cope with the demands of their corporate clients.

In order to cope with this load, it is necessary to:
- overstaff for the rest of the year, or
- employ temporary staff (often only inexperienced temporary staff are available).

In either case costs are higher than they would be if the 6 month period had been retained.

Alternatives such as a tax lodgment program adopted by tax agents in order to spread the workload are not available here.

It is also not possible to spread the workload by a amending the balance dates of superannuation funds. Such requests would generally be rejected by the ATO.

Recommendation:

Either:
- Return to a 6 month lodgment program, or
- Enable administration firms to adopt a lodgment program, or
- In conjunction with the ATO, allow funds to adopt non-30 June balance dates.

2. Acceptance of Contributions

Complex rules affect when a fund can accept a contribution for a person. This is particularly the case for members over age 65.

For a person over age 70, only contributions made under an industrial award can be accepted. Other contributions, including superannuation guarantee contributions cannot be accepted.

For a person over age 65, compulsory SG contributions and award contributions can be accepted but not other contributions unless the person is gainfully employed for at least 10 hours a week. Thus for a person over 65 who is only working 8 hours a week, voluntary employer, member or spouse contributions cannot be made.

For those under age 65, any contributions can be accepted if the person is gainfully employed for at least 10 hours a week. Similar provisions apply to those who have been employed for more than 10 hours a week in at least one week in the last 2 years, or are on Workcare or meet certain requirements relating to ill-health or parental leave.

In other cases, contributions cannot be accepted by a fund for those working less than 10 hours a week unless the employer is **required** to contribute because of SG or an award. Thus technically a fund may not be able to accept employer SG contributions for an employee working 7 hours a week and earning less than $450 a month because such contributions are not required under SG legislation. However the fund can accept contributions from the person's spouse.

The legislation is complex and is not helped by APRA's interpretation of the 10 hour a week rule. In broad terms, a fund is supposed to check monthly whether the member is working 10 hours a week. Averaging of hours over a longer period is not allowed. This results in situations where a person can contribute in some weeks but not others.

The acceptance of spouse contributions is also complicated. A non-public offer fund can accept spouse contributions (provided that the beneficiary spouse is under 65). Having accepted such contributions, it can accept a rollover of other superannuation benefits for the beneficiary spouse. However, the order cannot be reversed (ie the rollover benefit cannot be accepted until a spouse contribution has been made.)

Recommendations

- Remove all restrictions on accepting contributions at all ages, at least until age 70 (Part 7 of SIS Regs).
- Allow spouses of standard employer sponsored funds to become members without affecting the fund's non-public offer status irrespective of whether an actual spouse contribution has been made (Regulation 3.01).

At the very least the conditions applying under age 65 should be extended to persons aged 65 to 70. As noted earlier the existing provisions for those aged 65 to 70 are very complex for members to understand and for trustees to administer in the manner required by APRA. We consider Government policy should encourage people who can to work after age 65 and facilitate rather than complicate part time or irregular work by those in this age group.

3. Payment Of Benefits after age 65

Complex provisions apply.

For a person over age 70, the benefit in respect of pre age 65 accruals and any voluntary benefits accrued after 65 **must** be paid if the person works less than 30 hours in any one week. However, any benefit resulting from contributions made after 65 because of SG or award requirements does not have to be paid out if further such contributions are expected.

For a person between ages 65 and 70, similar provisions apply except that the test is based on 10 hours a week rather than 30.

These rules can result in situations where most of the benefit must be paid just because a person worked less than the usual number of hours in one week.

Again APRA's view is that trustees should check at least monthly on employment status and that hours worked cannot be averaged over a longer period.

Recommendations

- All requirements to force benefit payments to be made prior to age 70 should be removed.
- The 30 hour a week test after age 70 should be removed or amended to allow an average of 30 hours over a longer period. Trustees should not be required to check more frequently than annually.

4. Preservation

Preservation requirements were significantly simplified in 1999. However there are still aspects that require attention.

(i) In a number of cases, very small amounts are required to be preserved. If the preserved benefit is less than $200, it can be paid in cash however any interest added after termination of service is preserved. As there is normally a delay between leaving service and payment of the benefit, there are often uneconomically small parts of the benefit that are subject to preservation. These amounts could be as low as a few cents. In order to avoid the significant costs associated with either maintaining or rolling over such trivial amounts, many funds have decided not to credit interest in such circumstances. As the administration software would normally add interest automatically, this step has to be overridden, adding a further step to the process and hence increasing administration costs – but preferable to maintaining a preserved benefit of only a few cents.

(ii) Employers are required to make SG payments for employees who are expected to be in Australia for a short period. This means that short term workers who leave Australia must retain a normally small preserved benefit in the Australian system for, in some cases, 40 years. It is likely that the fund will, at some stage, have difficulty in finding such members. The members may also have difficulty in remembering or finding the fund when they are eventually able to claim their benefit. Administration costs will be higher than normal due to mail costs etc.

The Government has argued that it wants to use this as a bargaining chip in negotiations with other countries in order to obtain reciprocal rights. We note that many employees from overseas come from the UK and New Zealand. Both of these countries have allowed superannuation benefits to be transferred **to** Australia in similar circumstances for many years yet Australia is not prepared to reciprocate. This position often results in Australians effectively subsidising the administrative costs of maintaining a relatively small benefit for a member who is unlikely to ever return to Australia.

(iii) Regulation 6.16A applies in cases where a negative investment return is credited.

It requires that the negative interest be debited in a particular order, firstly to preserved benefits, then to restricted non-preserved benefits and thirdly to unrestricted non-preserved benefits. Thus in rare situations (a negative interest rate **and** a high proportion of the benefit being non-preserved) it will be necessary to reduce a member's non-preserved benefits. It is then not possible to increase the non-preserved benefit back to the original level when positive interest is again credited. The complexities of building these requirements into a computerised administration system are significant. In fact it is doubtful whether any administration system will be able to handle the requirements if it becomes necessary to apply it. Allowing the non-preserved benefit to increase again to its previous level would be an administratively easy option and would have almost no impact on the concept of preservation.

Recommendations

Part 6 of the SIS Regs should be amended as follows:

- The small payment provisions should allow "preserved" amounts under say $200 as at the date of payment (rather than as at date of leaving service or otherwise meeting a condition of release) to be paid in cash.
- Persons who are leaving Australia permanently should be allowed to transfer their benefit to a "suitable" retirement fund overseas. To prevent abuse, such transfers could be restricted to those who do not hold Australian citizenship.
- Regulation 6.16A should be amended to enable trustees to increase non-preserved benefits back to their previous level following a period of negative interest rates.

5. Funding and Solvency of Defined Benefit Funds

Each defined benefit fund that is used to meet SG requirements is obliged to have an in-force Funding and Solvency Certificate. Such a certificate must set out the minimum employer contribution rate over the period of the certificate to maintain assets above the "minimum requisite benefits" ie the minimum benefits required for SG purposes. Such a certificate can however mislead trustees and employers into a false sense of security, as this minimum contribution rate, whilst sufficient to provide the minimum SG benefits, may be insufficient to provide the benefits defined in the fund's rules.

To counteract this, many actuaries specify a higher than necessary "minimum" contribution rate so that an appropriate contribution rate is maintained. However this can often result in the need for a further FSC earlier than would otherwise have been necessary even in circumstances where solvency is not at risk.

The Regulations also require that the FSC specifies "notifiable events" that would trigger the need for a new FSC to be prepared. Difficulties here include:

- Adverse events occurring are not being notified to the actuary because the trustee has either forgotten about the requirements of the FSC or because the particular event was unforeseen and not specified in the FSC

- The requirements in the Regulations to replace an FSC even though it may be obvious to the Actuary that no adverse solvency issues have arisen. (For example, the FSC might require the trustee to advise of a significant level of salary increases. The mere notification can trigger the requirement for a new certificate yet the fund could still be in a very sound financial position because of higher than expected investment returns.)

Recommendation

We consider that discussions between APRA and the Institute of Actuaries of Australia could lead to revised Regulations that are not only simpler but also improve the level of financial control of defined benefit superannuation funds.

6. Actuarial Valuations of Pension Funds

Superannuation funds that provide certain types of pension benefit are required to conduct an actuarial valuation every year. (Modification Declaration 23 to Reg 9.31) (Other defined benefit funds are only required to conduct such valuations every 3 years.)

We consider that annual valuations are unnecessary, resulting in significant additional costs. The requirements are likely to discourage some funds from providing benefits in pension form.

We note that larger funds in a strong financial position can apply (with justification) to APRA for approval to have less frequent actuarial valuations (up to 3 yearly). However, these applications also cost money to prepare and must be resubmitted every 3 years.

It appears that the prime purpose of Modification Declaration 23 is to enable the Department of Family and Childrens' Services (Dfacs) to assess whether the pension is to be excluded or included for asset test purposes. If a "favourable" actuarial certificate is provided, then the fund's assets backing the pension are exempt from the asset test.

Modification Declaration 23 requires the actuary to place a value on the fund's pension liabilities that is considerably higher than that normally required in an actuarial valuation. In other words, a significant "reserve" is necessary before the actuary can give a favourable opinion. If a favourable opinion is obtained, the asset test exemption will apply. At the following years' actuarial valuation, it is likely that, unless the fund's investment return has been greater than expected, the reserve will no longer be big enough for the actuary to give another favourable opinion. Thus the asset test exemption will cease. The following year may be a year of strong investment returns that increase the reserve. A favourable certificate from the actuary will result in the asset test again applying for a year with the possibility that the exemption will again be removed the following year.

Such a system is not only costly to administer but is also extremely confusing to the public. It is also necessary for funds to comply with it, even if the pensioners have no intention of applying for Social Security benefits.

Modification Declaration 23 appears to have been an attempt to satisfy the often competing objectives of APRA, ATO and Dfacs.

The addition of Modification Declaration 23 means that SIS now requires the determination of 3 different values for the same pension:

- A value determined by the actuary for normal valuation purposes (Division 9.5 of SIS Regs).
- A value determined by the actuary for Modification Declaration 23 purposes.
- A value for RBL purposes (determined by the factors in Schedule 1B of SIS Regs).

These values are in addition to:

- A value determined by the actuary for determining the segregated (or un-segregated) pension assets for the fund's tax purposes
- A value determined by Dfacs for assessing whether there is a deprived amount
- A value specified in the fund's rules that is used for commutation purposes.

Thus there are potentially 6 different values for a particular pension – 5 of which are legislated.

Recommendation

We recommend the withdrawal of Modification Declaration 23 and for it to be replaced with a less costly and more consistent treatment of pensions for the purposes of solvency, tax and Social Security. Any replacement system should be developed in conjunction with the Institute of Actuaries of Australia.

7. Treatment of pensions and annuities

Part 1A of the SIS Regs sets out the standards that pensions must meet to be qualify as complying pensions for RBL purposes.

We have the following concerns:

- There are minor inconsistencies with the requirements in Social Security legislation for asset test exemption purposes
- There are inconsistencies in the requirements for different types of pension, for example it is not necessary for life time pensions to be indexed but life expectancy pensions must be indexed
- The indexation requirements are too prescriptive in that the Regulations at least imply that indexation must occur on the anniversary of the pension's commencement. (It would be far more practical for a fund to index all pensions in the fund on the same date, say 1 July each year, with a proportionate increase for new pensioners since the previous indexation date.)
- There are many inconsistencies in the value to be placed on pensions for RBL purposes (Schedule 1B of SIS Regs) particularly where pension indexation is at the discretion of the trustee.
- Where a retired person has arranged a pension benefit it should be easy to transfer that benefit from one fund to another if the pensioner is unhappy with the investment performance or the service provided by the existing fund. However Tax Office practice in the administration of Reasonable Benefit Limits means such a transfer can result in a pension previously assessed as within the RBLs being reclassified as partly an excess benefit resulting in partial loss of the pension rebate. Tax Office practice should be returned to that applicable prior to 1994 under which it was recognised that all a person in this situation had done was to change funds-there has been no change to the pension-so there should be no basis for a new RBL assessment.

Recommendations

- Inconsistencies should be removed and the requirements made less prescriptive.

- In our view, the treatment of pensions for both SIS, tax and Social Security purposes needs to be simplified. This should be a major topic to be considered as part of a major review of superannuation.

INTERPRETATION ISSUES

8. Election Rules

A major change to the trusteeship of superannuation funds in the last 10 years was the requirement for 50% of trustees or trustee directors to be appointed by members.

From an administration point of view, the requirement for elections etc has obviously meant an increase in costs.

Because of the turnover of employees, either due to resignation, retirement or transfer to distant locations, it is often necessary to replace a member appointed trustee much earlier than the date that the trustee's term of office would normally have expired.

It is important that costs be kept to a minimum and that a practical mechanism of finding replacements for casual vacancies be implemented. Whilst the legislation is not prescriptive on this issue, we are concerned that APRA's interpretation places too much emphasis on holding a further election rather than allowing a more cost efficient means of filling a casual vacancy (eg casual vacancies could be filled by nomination of the remaining member elected trustees).

Recommendation

That APRA take greater account of the costs of holding elections and revise their interpretation to enable more cost effective means of filling casual vacancies.

9. Reporting to Member Requirements

Funds are required to report to members on details as specified in the Regulations. However, superannuation is a complex topic and is full of jargon. Much of the jargon is legislative jargon (ie terms such as un-restricted non-preserved benefit). In order to properly explain details to members it is often preferable to report using every day English rather than jargon. We are concerned that, in some cases, ASIC have seemed to have adopted an overly prescriptive interpretation of the legislation in regard to reporting the words rather than reporting in an explainable form.

10. Preservation

APRA recently issued Superannuation Circular I.C.2. This Circular completely reversed an interpretation on the treatment of preservation following retirement after age 60. In our view the legislation clearly supports the previous interpretation and the new Circular appears to be in conflict with the legislation that has been in place for many years. In correspondence with APRA, we understand that APRA agree that the new Circular may not be consistent with the legislation. However, to date the Circular has not been corrected.

Recommendation

That APRA reissue Circular I.C.2 (particularly paragraphs 64 and 65) so that it conforms with the legislation.

11. Tax File Number Reporting

Funds are required to adopt various safeguarding procedures in relation to the collection and storage of members' Tax File Numbers.

The ISC put in place approved procedures for members to quote Tax File Numbers to their employer and for requesting and collecting Tax File Numbers directly from members. These methods are still on the APRA web-site.

We have concerns over the detail required in these approved procedures. They are too complex and often impractical.

The Tax File Number Declaration form issued by the ATO is the required means of advising an employer of an employee's TFN. This form can also be used to authorise the employer to pass the TFN to the employee's superannuation fund.

It is of concern that the details on this form do not comply with the ISC's (and presumably now APRA's) approved procedures. Once this form is in given to the employer, the employer is legally required to advise the superannuation fund even though the superannuation fund would then be in breach of the ISC requirements. This discrepancy has led to many funds putting in place complex and more costly procedures to try and comply with both the ATO and ISC requirements.

Recommendation

Either:

- Rescind the ISC approved procedures and replace them with more practical procedures that reflect the ATO forms, or

- Amend the ATO forms to reflect the requirements of the ISC approved procedure.