Submission to the Productivity Commission

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

About the Institute of Chartered Accountants in Australia

The Institute of Chartered Accountants in Australia (The Institute) is one of Australia's peak professional bodies and our members represent many of Australia's peak business and finance professionals. These members act as advisers and key decision-makers in all facets of the Superannuation industry.

The submission below represents the views of The Institute and has been prepared based on input from a variety of members in their capacity as employers, trustees, service providers and fund members.

Approach to the review

The approach taken in the preparation of this submission is to first outline our concern with the limited scope of the inquiry and to then address the questions posed in the Issues Paper. Closing with our comments on areas not addressed by the Issues paper.

1. Limited scope of the review

The Institute is concerned at the restrictions being placed on the review particularly the exclusion of areas relating to the amendments made by Superannuation Law Amendment Act 3 and 4. This legislation was complex in nature and the full impact of the changes is still becoming apparent. These recent changes have impacted on the ability of funds of a similar size and nature to compete on similar terms in the market place.

In our later comments we will be addressing the manner in which change to superannuation legislation is made and the problems which arise as a result.

2. Choice of Funds

It is clear through the reading of this paper that it is assumed that the Superannuation Choice of Funds measures will be introduced. The Accounting Bodies feel that given the delays in passing the Choice legislation that such an assumption is preemptive. As such recommendations to change the way in which this industry is managed should be delayed or include exemptions for non-public offer funds until they are subject to competition through the choice regime.

3. Issues Paper

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 benefit of the legislation is the complete package approach to the compliance aspects of running a superannuation fund. The Superannuation Industry (Supervision) Act 1993 (SIS) and the Circulars providing guidance and interpretation of the legislation is the primary source of information for fund trustees. This simplified approach makes compliance with the

legislation easier for trustees and the measurement of compliance by fund advisors and auditors more efficient.

The members of our organisation who act as auditors have reported a decrease in the incidence of significant breaches of the legislation with the consolidation of the compliance requirements into one act and with the improvements in guidance associated with SIS.

The requirement by the legislation for the advisors to make trustees aware of identified breaches and to work with them to rectify the situation has seen the development of a co-operative and educational approach to superannuation management. This approach leads to a stronger system as trustees do not fear recrimination when reporting breaches, which they have subsequently resolved or are resolving. This encourages true and fair reporting and improves the information available to regulators.

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 addresses all superannuation funds and provides clear guidelines by which products are developed. The clarity and certainty this provides is conducive to a level playing field between existing products in the market place and new entrants.

The legislation is clear on the acceptance of contributions and the payment of benefits, the key area by which funds are distinguished is the way they invest.

The legislation's open approach to investments enables funds to be innovative in the methods used to invest members monies. While many of the underlying investments are regulated by ASIC through the existing channels for investment markets, funds are not restricted to investing only in these assets. The legislation provides trustees guidance for the making of investments requiring them to give regard to risk, return, liquidity and members requirements. In particular investments in derivatives requires the trustees to put in place management processes and experienced personnel to reduce the risks of these investments.

Through the issue of guidance, as occurred with derivatives, the legislation and regulators are able to efficiently address concerns with particular investments and impose restrictions on the amounts invested and the processes required to be in place to assist in the protection of members assets.

Through this approach the act is able to be amended appropriately to address contemporary problems.

The one difficulty of working with SIS at the present time lays with the legislators. This arises where an area of concern has been identified and a proposed solution is determined by the Minister. This may be communicated to the public in the form of a public announcement but not followed through with legislation for sometime. This discrepancy between the policy intention and the legislation causes confusion for advisors and members alike.

The second challenge faced is failure to acknowledge in some instances that the one size fits all approach is inappropriate. This arose during the introduction of the Superannuation Legislation Amendment Act 4 changes to the measurement of in-house assets. As explained at the time the monitoring of these provisions is onerous and unwieldy to large industry and public offer funds and offers little in the way of protection and increases costs.

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?
The costs of compliance for superannuation funds are significant as with many other investment vehicles however the restrictive nature of superannuation contributions and benefits, and the complexity of the taxation system impose a particular burden on these entities.

The costs of accepting mandatory contributions and retaining benefits until preservation age could be reduced by removing the requirement to retain the benefits for persons who are in Australia for a temporary stay. This imposes costs on funds to provide information and maintain accounts and increases the likelihood of monies becoming lost and not being of benefit for the intended recipient.

While outside the scope of this review we feel that it is important to highlight the need to ensure that the costs of compliance do not exceed the benefits to be gained and that the introduction of new requirements are efficient.

An example of a measure which increased compliance costs is the superannuation surcharge. The collection mechanism put in place imposed a significant cost on both the ATO and superannuation funds, including resources which have been invested in subsequent years to improve the process and try to reduce costs. While the intention of this measure was to ensure an equitable tax outcome the processes put in place to gather the data have seen an increase in costs for all fund participants.

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?

Funds which are offered widely via the retail product market are subject to additional product disclosure requirements. This is representative of the method of promoting these funds and the optional nature of contribution to these funds. The FSRB may seek to apply these provisions to all funds this would see an unnecessary increase in disclosure for funds where there is no discretionary element to joining. The introduction of the choice regime will see retail funds and corporate funds offered to members. While comparability of information is important and may result in changes in disclosure documents care should be taken to ensure that the costs are not prohibitive and do not lead to significant decline in the number of corporate funds.

While outside the scope of this review we feel that it is important to highlight the inefficiencies and increased costs associated with the introduction of Superannuation Legislation Amendment Act 3 for certain less than 5 member funds. Funds whose trustee is an APRA Approved Trustee have had more stringent rules applied than Self Managed Funds leading to increased costs. The main differences are outlined below:

- Lodgment levies

The levies payable for Self Managed Superannuation Funds (SMSF's) administered by the ATO are $45 per annum. The proposed minimum levy for a Small APRA Funds (SAF's) is $300 per annum. This difference in fees is a significant increase in the anticipated costs for the supervision of funds. It was indicated that all funds would benefit from the reduced regulatory costs as APRA was able to take a consolidated approach to fund regulation by monitoring the Approved Trustee.

- Reporting requirements

As noted in previous correspondence SAF's have experienced a reduction of the reporting deadline from 9 months to 4 months. In addition these funds are required to produce a cashflow

statement which is a requirement not imposed on SMSF's. The reduced timeframe and increased reporting will increase the cost of account preparation and audit, without adding any value, as members of these funds have complete access to investment information on a regular basis.

- Information provision

Members of SAF's are required to be given new member information, annual member statements, annual member booklet and exit information. Previously the information to be provided was determined as a part of the agreement between the approved trustee and the members. This is an increase in the cost of operating these funds and the information does not often add value to the user who under the arrangement often has full access to any information requested.

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

The legislation has recently been amended to incorporate changes to government policy in relation to self managed funds and in-house assets. While the decision to change policy is the prerogative of the government we feel that ad-hoc decisions will lead to additional complexity. We have requested a full review of superannuation with an apolitical outcome for superannuation in future.

Any such review should result in clear policy objectives and a simplification of the superannuation system. Changes should then be accompanied by an education program

Further amendments are proposed to incorporate the treatment of superannuation as a property asset on divorce. This will see the legislation governing superannuation increase in complexity as these provisions will be in the Family Law Act. This will require superannuation fund to source information about benefit payments from both SIS and the Family Law, thus increasing the costs of regulation and compliance.

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?

SIS provides an adequate balance between legislation and regulation without imposing prescriptive regulations on areas such as investments while providing clarity and certainty in areas such as benefits and contributions. Standardisation of the rules in these later areas are important as the introduction of varying rules would cause uncertainty and confusion amongst members. The ability of funds to invest as they see fit within guidelines provided by the regulators enables funds to adapt investment strategies to members needs.

The legislation recognises the desire of some participants to be actively involved in the way the fund of which they are a member is managed and enables them to do this through the election of member representatives. The equal representation system brings together a panel of individuals with varying experiences to look after the needs of their members. The introduction of a managed investment style of legislation will see a move away from non-professional trustees towards the retail market. This further concentration of the market will reduce competition and may lead to increases in costs.

This would occur as self managed fund and corporate fund trustees would not be in a position to meet the education and experience requirements of operating an entity. This would further concentrate the market and reduce the availability of funds that offer small business choice in the type of fund they operate.

In particular the removal of self managed funds as an investment vehicle will see a reduction of the investment in small business as these funds are currently able to invest in business real property. This investment enables a small business to purchase a business property using superannuation fund assets with the business renting the property from the fund. This frees up capital for business growth while protecting the superannuation fund which has a physical property asset which can be sold when necessary.

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?
The present trustee structure can be likened to a company governance structure as the members are either trustees, in the case of self managed funds, or appointed by participants, in the case of corporate funds. The trustees have a responsibility to look after the interests of members and achieve this in some instances through the appointment of advisors. These advisors act on behalf of a number of funds and provide economies of scale in the administration of funds. This is in much the same way as small companies use advisors in the preparation and lodgment of information to the regulators.

Legislation-specific issues
SIS Act

- *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?
As discussed above the use of other entity structures will see a reduction of the types of funds available to accept superannuation investments, leading to a reduction in competition in the industry.

Are the duties and obligations imposed on trustees warranted or do they involve excessive costs?
The duties imposed on trustees are in line with those imposed on directors and others involved with the investment and management of other peoples monies. For the most part these are not excessive and are appropriate for the task with which they are charged.

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

Equal representation gives members the opportunity to participate in the management of their assets.The appointment of a trustee board jointly by the employers and employees gives all participants the opportunity to ensure that the best interests of all parties will be considered.

This is distinguished from the retail sector where it is the company directors that appoint the trustee board. In the retail sector the involvement of fund participants is minimal as the company shareholders appoint the company board however the investors in the underlying investment funds are not consulted. While the trustee board is charged with a fiduciary duty to look after members interests, it is likely that corporate interests will also be considered.

The equal representation system relies on the collective knowledge and skills of the trustees to administer the fund. Some corporate superannuation funds will find the costs and experience requirements of licensing trustees prohibitive and choose to wind up reducing competition in the market place.

- *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?

The information requirements of SIS distinguish between types of funds recognising that the size of the fund, the methods by which investors become members giving differential requirements for each fund type. The requirements are suitable for each type of fund however savings could be made via the production of a generic booklet that explains contributions, benefits, reasonable benefit limits and other standard terms. This information could then be excluded from the member booklet provided to each member on joining which would focus on details specific to the particular fund.

The changes to contributor status have occurred during recent years due to changes in government policy. Any further changes should occur as a result of a comprehensive review of superannuation. We do not envisage any significant savings in the relaxation of these provisions.

- *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 SIS Act provides for the consistent treatment of superannuation funds in relation to the acceptance of contributions, investments and benefits. While the regulation of larger providers under the Managed Investment Act would reduce the costs of regulation for these providers, however the change would impose costs of restructure on smaller market participants. These costs would be seen as an additional burden on members and may see some funds leave the market reducing competition.

Does the exemption of some public sector superannuation schemes raise any issues for this review? What are the benefits and costs of this differentiated approach?
Public sector superannuation funds are treated preferentially due to their association with particular groups within government. This treatment does not impact on the cost and benefits of other funds however this does give a perception in the public arena for the members of these funds. For example the ability of parliamentarians who are not re-elected to take an income stream from a young age is seen to be a perk of office that others are unable to avail themselves of.
This causes dissatisfaction in the market place and seems unreasonable when compared to a 55 year old retrenched person who is required to draw down on their superannuation prior to receipt of an unemployment benefit.

- *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 investment provisions enable funds to invest in accordance with guidelines set down by the regulators. These guidelines are generally not prohibitive. However the reporting provisions surrounding the governance of derivatives are somewhat costly and could be streamlined.

- *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 use of a net tangible assets model to ensure that the investment manager is of a sufficient size and hence protect superannuation assets is ineffective as a form of protection. The assets being managed usually far exceed the NTA amount, it is therefore the skills and systems of the investment manager which are of most importance when considering their ability to appropriately manage fund assets. This could be better supported by the regulation of investment managers and custodians by ASIC. This is increasingly the case for those managers offering both retail and wholesale services.

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?

The results of compliance audits are used by the regulators to take a risk based approach to the regulation of superannuation funds. The detailed reviews of calculations and financial statements performed during the audit give the regulator comfort that the funds are being operated in accordance with SIS and their Trust Deed. This reduces the work performed by the regulator when undertaking fund reviews as the work of the auditor is considered as a part of the overall review.

There are some audit requirements related to risk management statements which are timely and ineffective adding little to the regulation of the fund. These relate to the auditor signing a separate audit report for trustees using custodians that a risk management statement is /or is not required and has been obtained as required.

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

There are some products, such as an allocated pension, where an actuarial review is irrelevant yet in order for the fund to avail itself of the relevant tax deduction an actuarial certificate is required. It is recommended that a review of these provisions take place to ensure that an appropriate outcome is achieved for funds and regulators.

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?

The arrangements with service providers are in the form of written contracts and the services included in the contracts will vary depending on the needs of trustees. Due to the lack of standardisation it would be inappropriate to specify the specific functions to be performed by the service provider in SIS. However the requirement to appoint service providers in writing should be included as well as provisions which would enable the fund trustees to take action against a service provider. This would arise where a significant breach of SIS arose due to the administrators action/ inaction.

- *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 regulators have clear roles and there are no apparent overlaps in regulation. One gap that arises from time to time occurs where the fund invests in assets which later experience difficulties or fail to materialise. This gap can occur in all investment industries and cannot be prevented by the regulators or industry participants such as auditors.

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 circulars issued by APRA generally reduce the costs of compliance as they provide clear guidance on the interpretation of SIS and enable processes to be put in place which ensure compliance.

From time to time the regulator uses its discretion to amend a requirement for a fund or group of funds. Where this occurs we would like to see the notification of concessions provided to all participants in that particular market sector to ensure a consistency of treatment for all funds.

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?
As in most industry's there are breakdowns in the system of regulation however the superannuation industry has experienced a limited number of these. The regulators have been effective in monitoring funds to ensure compliance and taking action on those funds not being managed appropriately.

The costs of monitoring funds are warranted however there is duplication of levies in relation to Pooled Superannuation Trusts (PST). These funds are only able to accept the monies of other superannuation funds that have already been levied, the monies are then levied again in the hands of the PST. The levy on a PST should ideally not exist or should at least be reduced to avoid the double levy on funds which invest in this class of trusts.

Do the penalty provisions provide appropriate incentives for compliance?
The penalty provisions provide incentives for compliance particularly the threat of loss of complying status at the small end of the market. At the larger end of the market it is likely that this penalty would not often be applied. However the impact of the criminal penalties acts as a deterrent.

Superannuation (Resolution 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? 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 requirement to seek redress through internal complaints mechanisms and conciliation weeds out vexatious and minor dissatisfactions and helps to ensure that only cases where there is a serious grievance are brought to the tribunal. This keeps the costs of operating the tribunal low.

Fund trustees are required to provide both parties with the appropriate information to explain their decision and in some cases that of their insurer. In this instance the majority of costs are already borne by the fund. Funds also have responsibility for the first steps towards the resolution of complaints through their internal complaints mechanisms.

Many mechanisms deal with issues related to the selling and selection of financial products whereas the complaints to this tribunal relate to the admission of death and disability claims. The outcomes of cases often bind both the fund and the funds insurer.

Prior to the challenges to the jurisdiction of the Superannuation Complaints Tribunal the tribunal was operating effectively. The challenges saw a backlog of cases while issues were resolved however these have now been overcome and cases are progressing through the tribunal in a timely manner.

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?
Given the strong regulatory framework the superannuation industry operates under, the frequency of loss as a result of fraudulent conduct or theft is low. A requirement to contribute to an emergency reserve would create a pool of money that would be used infrequently and would disadvantage all members though lower returns as this is a drain on the funds available to be invested for the benefit of members.
We see the present provisions as suitable to meet industry's current requirements to protect innocent members while not adversely impacting all members.

The introduction of a fidelity fund raises queries about its management and control; to enter into such an arrangement would in itself introduce costs that would see an increase in the cost of supporting members who suffer loss at the expense of all other fund members.

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? Does the amount of the levy appropriately reflect the ATO's cost of supervising self managed funds?
The levy is used for the regulation of self managed superannuation funds (SMSF's). Since the introduction of this levy the ATO have undertaken education of new trustees and have implemented a monitoring program for compliance.

This levy represents a significant decrease in levies applied to SMSF's which had cross subsidised larger fund regulation for a number of years.

Occupational Superannuation Standards Regulations Application Act
Does administration of this Act involve unnecessary administration costs? Would it be appropriate to terminate these provisions?
There are very few funds which have not elected to be regulated. These funds would generally be subject to a windup which is being delayed while the status of assets or beneficiaries is being resolved. This does not impose compliance costs on regulated funds.

The retention of these provisions is required for an ever decreasing number of funds. From discussion with members there is little evidence these provisions will continue to be required after 1/7/04.

4. Concerns not covered by the Issues paper

Dilution of the SIS package
As noted above we are concerned that recently proposals have been put forward which see the dilution of the SIS package. The strength of the SIS Act is the consolidation of the principal administrative compliance requirements into one set of legislation and regulationswhich makes compliance with the legislation more efficient.

This is also of advantage in relation to regulation as it sees the industry regulated principally through APRA who are able to provide clear and concise guidance on the legislation. While the ATO regulates a sector of the industry the ATO also places reliance in the APRA guidance and does not issue advice that conflicts with that of APRA.

The introduction of compliance requirements into other legislation will see increase in complexity as other legislation emerges.

Delays in legislative change
We have seen announcements which propose a number of measures such as changes to the residency status of self managed funds. There is often a significant delay between the making of an announcement and the introduction of legislation to give it affect. This causes confusion in the market place and increases the cost of monitoring compliance as transitional provisions often accompany any subsequent change.

We encourage the legislators to give priority to announced changes to ensure that all participants are complying on the same basis.

Complexity of Superannuation Taxation
When considering the cost of compliance with superannuation legislation the key area identified as requiring reform is the taxation of superannuation. Superannuation taxation is complex with three stages of taxation on contributions, investment income and benefits. In addition to this are the superannuation surcharge and GST requirements, which are accompanied by complex information gathering mechanisms that can be costly to maintain.

Recent taxation reforms have seen changes to capital gains tax and refunds of imputation credits. While these changes are positive in reducing the tax payable by superannuation funds the complex mechanisms and calculations required to take advantage of the changes increase compliance costs.

A review of taxation is required to ensure we have a system which meets the governments revenue requirements while reducing the costs of compliance with tax legislation.

5. Conclusion
The Institute of Chartered Accountants in Australia and its members are overall, comfortable with the structure of the Superannuation Industry (Supervision) Act and associated legislation; its strengths are the complete package approach to regulation including all relevant legislation in few sources.

We encourage the Commission to support this approach and to highlight the importance of retaining a complete package approach as the benefits of such an approach help control the costs of compliance.

We seek your support in encouraging legislators to perform an overall review of retirement incomes policy ensuring Australia has a strong bi-artisan policy which will reduce the need for regular changes to superannuation legislation in the future.