WILLIAM M. MERCER

19 October 2001

Mr. J Cosgrove
Presiding Commissioner - Review of Certain Superannuation Acts
Productivity Commission
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Dear Commissioner Cosgrove,

SUBMISSION ON DRAFT REPORT ON THE REVIEW OF THE SUPERANNUATION INDUSTRY (SUPERVISION) ACT 1993 AND CERTAIN OTHER LEGISLATION

William M Mercer has previously made a submission to the Commission and, following the release of the Commission's draft report, would like to add further comments. We thank the Commission for this opportunity, and also for its efforts so far. We are generally in agreement with the recommendations in the draft report.

Our additional comments are set out below. These mainly concentrate on those areas where we have some disagreement with the Commission's comments or wish to add further clarification.

Net tangible asset requirements and operating capital requirements for approved trustees (Draft recommendations 4.1 and 4.2)

The current requirements effectively require that (ignoring the custodial arrangements) only organisations of some substance can become Approved Trustees. However, we are unsure if there is any other purpose for the net tangible asset and operating capital requirements. It is certainly unclear in what circumstances the net tangible asset would be called upon to provide additional benefits or security to members.

Increases to the current requirements are unlikely to promote efficiency and may lead to a lessening of competition. With the above comments in mind, it is not clear that increased requirements will lead to any greater security for members.

We also note that this matter has been covered in the Minister for Financial Services and Regulations' recent paper on improving the safety of superannuation. We will be making a more detailed submission on that paper after having given the complex issues involved more consideration.

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Compliance Audits (Draft recommendation 4.3)

We agree that compliance audits could be performed by other suitably qualified people. This would include actuaries and lawyers.

Age and employment requirements governing contributor status and compulsory cashing of benefits (Draft recommendation 5.1)

We strongly support a simplification of the requirements. This would include similar treatment for those over 65 to that applicable to those under 65.

The current rules regarding the acceptance of contributions are unnecessarily complex. The complexity is highlighted by the fact that the Overview in the Commission's draft report has misinterpreted these requirements for those over age 70. Even Table 5.1 in the draft report which is extracted from APRA sources, although more accurately representing the requirements, could mislead readers in respect of contributions for those over age 70.

We do not agree with the suggestion in this recommendation that responsibility to provide the required information be placed on members, with appropriate penalties for non-compliance.

As they stand, the tests are so complex that it would be unreasonable for older persons to be expected to understand them and know when to provide the required information. We would expect that a significant proportion of members would be unaware of any such requirements. The imposition of penalties on people's retirement savings in these circumstances is inappropriate. In our view, it would be far better to review the requirements so that there are no differences based on age. If any age barrier must be imposed, it:

- should not be before age 70;
- should apply both to the acceptance of contributions and the required payment of benefits; and
- should not depend on employment status.

Such an approach would be simple to understand and administer. All that would be required would be the member's date of birth.

Non-resident members (Draft recommendation 5.2)

Whilst we agree with the thrust of the recommendation in the draft report, we are concerned that if a limit is imposed, the chosen limit may be too small to be effective. We would suggest that the limit be no less than $20,000. Even this limit would create problems. For example, an overseas employee temporarily working in Australia on a 3 year secondment earning $100,000 pa would exceed this limit with only superannuation guarantee contributions.

As an alternative, we consider that transfer of benefits of any size be allowed provided that the transfer is made to a bona fide superannuation fund in the member's new country of residence or home country.

We also note that these problems would be reduced if employers were not required to make Superannuation Guarantee contributions in respect of employees who continue to be entitled to ongoing employer contributions to a superannuation fund in their "home" country. (There would also need to be changes to tax law to enable contributions to such bona fide funds to be tax deductible if paid by the Australian employer and to be exempt from Fringe Benefits Tax.)

We are also concerned with the difficulty faced by members trying to transfer their benefits in an overseas superannuation fund into their Australian fund. The current 6 month period for transfers to avoid Australian tax is, for practical purposes, too short. Further, if tax is payable, it must be paid by the member. The amount transferred to the superannuation fund is not available, due to preservation rules, to pay the tax. Where the tax is large, this effectively means that the member cannot afford to transfer the benefit to Australia.

Provision could be made to allow the withdrawal of part of the benefit in order to pay the associated tax in a similar manner to the way in which superannuation pensions can be commuted in order to pay a member's surcharge tax liability.

Review of Risk Management Statement requirements (Draft recommendation 5.3)

We are in general agreement with the proposals to simplify and review the requirements for Risk Management Statements. The current system is inefficient and concentrates too heavily on derivatives.

As an example, we are aware of a situation where a fund had to engage an auditor to audit a trustee declaration that it did not need a Part B RMS (because the fund did not invest directly in derivatives).

We consider that the best approach would be for the requirements to be revised by a group of industry representatives working with APRA. ASIC could also be involved due to its role with unit trusts which are used by many superannuation funds. Mercer would be happy to be part of such a group.

Issues to be considered should include:

- The content of the RMS
- How it links with Investment Policy Statements
- Who should be required to prepare an RMS (the trustee, the investment manager or both)
- How should the system be monitored (eg should there be a form of compliance audit by a licensed investment adviser?)
- How can trustees be given greater comfort of an investment manager's risk management procedures?

Licensing (Draft recommendation 7.1)

We are concerned with the draft recommendation. Under the FSR legislation, many trustees will, subject to the activities they undertake, need to obtain a licence under that legislation. At this stage, we fail to see any advantages in requiring trustees to also obtain an APRA licence. The need for operating capital is also questionable.

As these issues are also canvassed in the Minister for Financial Services and Regulations' recent paper, we will be providing more detailed comments in our response to that paper, once all of the relevant issues have been considered.

However, at the present time we see no advantage in the proposals for APRA licencing and capital requirements for corporate or industry funds. We expect that such requirements would not only but also reduce competition and result in lower returns to members if capital requirements need to be funded from members' assets.

Further it would be necessary for legislation to clearly specify in what circumstances the capital requirements would be called upon to support members' benefits.

We also note that licensing and equal representation may be almost mutually exclusive. (We note elsewhere the Commission's support for the equal representation system. It would be a concern if this system could not operate effectively due to licensing requirements.)

Superannuation Complaints Tribunal (Draft recommendations 8.1 to 8.3)

At this point of time we see no need to replace the SCT. The tribunal appears to be operating reasonably efficiently. We have not seen an appropriate case to indicate that an industry based dispute resolution scheme will be more efficient than the current arrangements. Requiring all funds to join a suitable scheme would appear to be just another unnecessary requirement on trustees.

Such a change would also result in a costly communication exercise for many funds. Member information booklets and other communication material would need to be amended and reprinted to remove existing references to the SCT and replace it with references to the new dispute resolution scheme.

We also do not agree with the recommendation that the Tribunal should publish the names of the superannuation entities that are the subject of complaints that are determined by review or arbitration. There are 2 main reasons for this:

- By naming the superannuation fund, in many cases, particularly in relation to corporate superannuation funds, it will be obvious who the complainants are. This would be a serious breach of privacy and in our view is inappropriate. The SCT currently publishes its decisions and these decisions include significant details of the complainants' financial and private affairs. Publication of these details (on a no names basis) is necessary if these decisions are to be used by the industry as guidelines in other cases.

- Publishing names of superannuation funds may imply wrong doing. In most cases before the tribunal, there is no element of wrong doing. Many cases relate to the payment of death benefits. The trustee may make a decision in relation to whom the benefit should be paid. The fact that the SCT may have a view that another of the competing beneficiaries has a "better" claim does not mean that the trustee has done anything wrong. It just came to a different decision than the SCT. Similarly, disability claims must be decided using judgement. Decisions as to whether a

member will be able to work again are not straightforward. In some cases the SCT's judgement will differ from that of the trustee. This does not necessarily mean that the trustee was wrong. It will only be possible to tell who was right or wrong at some point of time in the future.

Other Issues

Lodgement of annual returns (Draft finding 5.1)

We remain concerned about the 4 month requirement for lodging annual returns. Whilst it is extremely difficult to measure the cost impact, this requirement places continuing strain on administration, accounting and auditing resources. These returns must be completed at the same time as funds are struggling to complete the extremely complex superannuation surcharge reporting requirements.

We acknowledge that it is preferable for APRA to receive information earlier rather than later when a fund is in or moving towards financial difficulties or there are other prudential issues. However we are not convinced that the 4 month requirement will result in APRA discovering such cases any earlier. Funds in such a position are the most likely to miss the deadline in any event.

At the very least, we believe that the Commission should recommend that funds be given the option of choosing a date other than 30 June as its year end. This would enable administrators, accountants and auditors to spread their work load more evenly over the year and hence minimise costs.

Trustee representation (Draft finding 6.2)

We appreciate the Commission's support for the concept of equal representation. It is a system in which members can become actively involved and assists in the prudent management of the fund.

For a corporate fund, there is little option in most cases but to hold an election in order to appoint member representatives. We agree that the benefits of the equal representation system warrants the costs of the election procedures.

However we remain concerned with the costs involved in filling vacancies arising during a term of office.

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There are several established means of filling vacancies:

- Carry out a new nomination and election process (costly and time consuming)
- Fill the vacancy in accordance with established procedures. These could include:
  - Appointing the next highest unsuccessful candidate at the previous election (often this is inappropriate as there may have been no such candidate that is still eligible and willing, or this person may have received minimal support from the membership at the last election); and
  - Member nominees, at the time of nomination, declaring a specific substitute should they leave during the term of representation (This would make the initial process more complex and make it more difficult to obtain nominations. In any event, the specified substitute may no longer be eligible.)

A more appropriate approach would be to allow the remaining member representatives to nominate a replacement. This approach was previously accepted by APRA. However, more recently APRA has indicated that it is not acceptable unless there is a short period until the next election. In our view it is the most logical and practical means of filling a vacancy and results in considerably less cost than holding another election.

In conclusion, we again thank the Commission for its work and indicate our willingness to appear at the Commission's public hearing in Melbourne later in October.

Yours Sincerely,

John Ward
Manager
Research and Information