INTRODUCTION

This brief submission is made in relation to the Draft Report published in September 2001 by the Productivity Commission ("the Commission") as part of its Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation ("SIS Legislation").

Specifically, our comments in this submission are limited to the two options identified and recommended by the Commission involving modifications to the SIS Legislation, namely:

- Option 1: Improve Specific Areas of the Legislation
- Option 2: Introduce an Effective "Licensing" Arrangement

(Draft Report, Chapter 7, pp 115 *et seq*)

SISFA welcomes the opportunity to participate further in the Commission's inquiry. However, we remain committed to our longstanding position that Australia's superannuation system **as a whole** requires immediate review, with a view to establishing a sustainable long-term retirement incomes framework. Consequently, such a review must also address the taxation aspects of superannuation and its interaction with the social security system. We note the Commission's limited terms of reference of the present inquiry, but we are heartened to see the Commission's own acknowledgement of the risk associated with such an isolated review. In this regard, the Commission stated:

> Piecemeal legislative changes involve a risk of overlooking connections between various elements of policy and are unlikely to deal satisfactorily with the difficulties faced at present by those supplying and investing in superannuation assets. A more wide-ranging review which considers the above matters in an integrated way would be likely to lead to better design and implementation of superannuation policy and enhanced community understanding of how to use superannuation as a form of saving for retirement income.
> (Draft Report, p. xxix)

SISFA emphatically endorses these remarks, and we consider that they should be assigned at least the same degree of importance as any of the Commission's other findings.

COMMENTS ON THE DRAFT REPORT

Option 1: Improve Specific Areas of the Legislation

Of the improvements suggested by the Commission in its report (pp 117-118), SISFA considers the following areas should be given priority:

- Simplification of the age and employment requirements governing contributor status and compulsory cashing of benefits. In particular, the contributions acceptance rules should be amended to deal with obvious inequities and anomalies in the current provisions (e.g. eligible spouse contributions).

- Restrictions on the transfer of superannuation benefits of bona fide non-resident short-term employees, including genuine emigrants from Australia.

Both of these issues were raised and addressed in some detail by SISFA in our submission to the Commission in May 2001, and our position on each remains unaltered. In relation to the contributions acceptance rules, we believe that the major aspects of our proposed changes could be implemented with relative ease in the short term and with the following benefits:

- promoting broader superannuation coverage;
- removing barriers to participation in superannuation;
- encouraging continuing participation in the workforce by older Australians;
- removing some of the inherent complexities of the current system; and
- reducing discrimination based on age, marital status or employment status.

We are of the view that changes to either or both of the above areas could proceed without detracting from the need for a broader review of our retirement incomes system.

SISFA also expresses its interest to participate in any APRA review of the requirements relating to compliance audits, and in this respect we draw to the Commission's attention the progress made on superannuation fund audits generally by the Senate Select Committee on Superannuation and Financial Services.

Option 2: Introduce an Effective "Licensing" Arrangement

SISFA reserves its final position in relation to whether the "licensing" of certain superannuation entities will improve the prudent management and prudential supervision objectives of the SIS Legislation. We also note that this matter is covered in the Issues Paper, "Options for Improving the Safety of Superannuation", released by the Minister for Financial Services & Regulation on 2 October 2001.

However, at this stage, we are not convinced that a licensing regime is necessary or will improve existing arrangements. This statement is based on our view that, subject to suitable quantitative analysis, many of the "small" funds identified by APRA (apparently comprising some 1800 in number according to APRA) as having the highest concentration of potential problems, may not require the extent of prudential supervision currently contemplated by the SIS Legislation. Consequently, the perceived need for a licensing system may not be as great as is thought to be the case, and we believe that there may be an alternative and preferred approach to supervising this class of funds.

Background to an Alternative Approach

Currently, self managed superannuation funds are effectively excluded from many or most of the prudential regulatory requirements of the SIS Legislation. Prior to the enactment of the Superannuation Legislation Amendment Act (No.3) 1999 ("SLAA 3"), **all** superannuation funds with fewer than five members were excluded from such requirements.

One of the stated policy objectives of SLAA 3 was to ensure that the members of those funds not to be subject to prudential supervision were in a position to protect their own interests.

Prior to the SLAA 3 changes, it was possible for a fund with fewer than five members to include genuine arm's length employees, and yet be exempt from the increased disclosure and other prudential standards—clearly an undesirable consequence.

It remains our view that the "fewer than five members" criterion for self managed superannuation funds possibly excludes a significant number of funds from being so categorised, albeit the composition of their membership and the relationship among the members and trustees are identical in nature to self managed superannuation funds.

At the risk of over-simplifying our position, it is our opinion that only those funds that contain members genuinely at arm's length from the trustees and/or employer-sponsor should be subject to the prudential standards of the SIS Legislation.

Fewer than 5 Members

Should there be an upper limit of 4 members in determining whether additional prudential regulation is required? Consideration of the history of the notion of "fewer than 5" is necessary to answer this question.

It seems that the distinction between funds with fewer than 5 members and those with 5 or more was drawn primarily for disclosure purposes.

Up to the year ended 30 June 1992 the requirements for trustees to provide benefit and fund information to members were set out in subregulation 17(1) of the OSS Regulations. Those requirements applied to all funds, irrespective of the size or composition of their membership.

From 1 July 1992 a new disclosure regime became operational through the insertion of new Division 2 in Part II of the OSS Regulations. The new requirements applied in part to all funds (general disclosure requirements), but also imposed additional reporting rules on funds that had 5 or more members (referred to as "multi-member funds").

The SIS Act preserved this membership cut-off by excepting excluded funds from several provisions of the SIS Act.

The "fewer than 5" regime thus effectively emerged from a disclosure rather than a prudential regulation perspective.

In our opinion, the number of members is not an effective determinant for categorising a fund for prudential regulation purposes. Rather, it is the **composition of the membership of a fund that should be the determining factor**. On this basis, any fund with at least one genuine arm's length member should be (and is in fact) subject to the full prudential standards. Unfortunately, however, the opposite is not always the case under the SIS Legislation—that is, not all funds without genuine arm's length members are self managed superannuation funds. Rather, they must also have fewer than five members to be so categorised.

It is our view that there is a need to debate the specific issue of whether "fewer than five members" remains a defining characteristic. Such debate should cover the following major points:

- Whether there is a proven need to set an arbitrary upper limit to the number of members for the purpose of determining the nature and extent of a superannuation fund's prudential supervision;
- If so, whether a maximum of four members remains appropriate.

As discussed in the arguments we have presented thus far, we submit that the use of an arbitrary number of members is inappropriate for the purpose of determining the extent of prudential regulation that a fund requires.

The test should rather be based on the relationships between fund members and/or trustees.

The number of members should at best only be relevant in applying trustee standards, internal disputes resolution mechanisms, and determining the extent of disclosure to members.

Application to Licensing Proposal

Further analysis of APRA's statistics reveals that some 1047 of the 1800 potentially problematic funds have assets under one million dollars, and an average membership of around 17. We believe that many of these funds may be limited to family members/business associates with fewer than 10 members, and closely resemble self managed superannuation funds with the exception of their membership size.

For these reasons, SISFA's preference is for an immediate analysis of the detailed composition of the membership of the 1800 "small" funds identified by APRA, with a primary view to establishing how many thereof include arm's length employee members. Until this data is available, we do not consider that any form of new licensing regime can be developed, as the exact nature of the funds thought to require prudential supervision is not clear.

SISFA remains committed to the notion that more education of trustees and enforcement of existing regulations are required, rather than the introduction of new, possibly more restrictive provisions.

In closing, we make the observation that some of the notable superannuation fund failures or losses in recent times have involved APRA approved trustees—that is, entities currently "licensed" by APRA. This begs the question of whether further licensing will provide a viable long-term solution to any **perceived** problems. We are also concerned to ensure that if any progress is in fact made on the licensing proposal, any potential overlap with trustees' obligations under the Corporations Act and Regulations is addressed.

We welcome the opportunity to discuss any aspect of this submission in further detail.

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For and behalf of SISFA