<u>Productivity Commission 2001,</u>

Superannuation Industry (Supervision) Act 1993 and certain other Superannuation Legislation

Draft Report, Canberra, September

By way of introduction, we note the following observation by the Productivity Commission in the "**Overview**" to the Draft Report, at Page XXIX, as follows: -

> *"The scope of this inquiry is relatively narrow, focussing for the most part on the legislation governing prudent management and supervision of superannuation funds. During the course of the inquiry, some participants have expressed dissatisfaction that broader issues of superannuation policy (covered by other legislation) are excluded. It has become clear to the Commission that, complex as the SIS Act is, superannuation policy overall is even more difficult for practitioners to implement and for members of the community to comprehend.*
>
> *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".*

We wholeheartedly concur with the conclusion that *"[p]iecemeal legislative changes involve a risk of overlooking connections between various elements of policy"*. To this end, we would strongly endorse the creation of a "centre of expertise" with respect to superannuation policy which would have direct input into the process of legislative change. If it were not felt appropriate that such a body be located within a regulator such as APRA, it may be more appropriate to ensure that a body of specialised knowledge be formed within an appropriate branch of the Department of the Treasury.

Turning to "**Chapter 2, The Superannuation Industry**", under "**Part 2.4, Industry Composition - Superannuation Funds**", the statement is made on Page 20 that: -

> *"The remaining funds are defined in terms of the SIS Act as either standard employer sponsored or public offer funds"*

While not a great deal turns on the distinction, it may be worthwhile clarifying that "standard employer sponsored" and "public offer" are not mutually exclusive terms. Whilst it is possible for a superannuation fund to be one or the other, a number of funds are both.

On Page 21 the statement is made that: -

> *" ... there may be no scope for voluntary contributions to be made to corporate or public sector funds, and limited scope to make such contributions to industry funds. In contrast, retail funds offer a broader range of superannuation products (such as tax-effective pensions and annuities) and contribution acceptance arrangements (such as those on behalf of a spouse or for self-employed persons) which provide greater scope for making voluntary contributions. As a result, retail funds compete among themselves for the bulk of voluntary superannuation contributions".*

While it is possible that public sector funds in particular, and possibly some defined benefit corporate funds, may limit the scope to make voluntary contributions, industry funds generally encourage the making of voluntary contributions as much as do retail funds.

The majority of industry funds accept voluntary contributions from employees through a variety of means, including through payroll deduction by their employer (either after tax or salary sacrifice), by cheque (either in person or through the mail), or via direct debit. Similarly, former standard employer-sponsored members, including those who may have become self - employed or may now be employed by a non-contributing employer, are encouraged to continue to make voluntary contributions.

Furthermore, most industry funds accept contributions with respect to spouse members. In addition, a number of industry funds offer an allocated pension.

Of course, those industry funds which are also public offer funds compete directly with retail funds for voluntary contributions from the public.

Under "**2.5, Operating Costs - Administration Costs**", at Page 25, the statement is made as follows: -

> *"Eligible rollover funds, an important avenue for the maintenance of small and lost member accounts (among other things), had the lowest estimated administration cost — $15 per member per annum. Eligible rollover funds do not offer scope for regular contributions, however, and provide relatively low rates of return due to their capital-guaranteed nature".*

Whilst the statement with respect to Eligible Rollover Funds ("ERF"s) not offering scope for regular contributions may be a factual observation, there is nothing in the SIS legislation which precludes them from so doing.

Admittedly under the SIS legislation as initially enacted ERFs could not accept voluntary contributions, however, these provisions were among the first to be amended in late 1994. One of the outcomes of these amendments was to effectively allow ERFs to operate as a "normal" superannuation fund, provided of course that they observed the additional requirements of being an ERF, namely, that they continued to accept all roll-overs and transfers in and to protect all members.

In "**Chapter 3 - The SIS Legislation**" - under "**3.3 - The SIS Act and Retirement Incomes Policy**", at Page 36 it is stated: -

> *"Some developments in the superannuation industry, such as the closure of significant numbers of funds, might suggest that the SIS legislation is deterring competition. On the other hand, some indicators could suggest that any such influence is not major".*

It has been suggested that the closure of significant numbers of funds is as a direct result of the costs, both direct and indirect, of complying with legislation, however, it is generally not the SIS legislation which serves to deter competition but the tax legislation and, in particular, the surcharge.

In "**Chapter 4 - SIS Legislation: Restrictions on Competition**", under "**4.1 - Approved Trustees**", under the heading "**Benefits**" on Page 40 it is stated that

"Benefits

> *"To date, there have been few failures of funds managed by approved trustees. While this outcome may be attributable to a number of factors, the statutory requirements imposed on approved trustees, together with the attendant improvement in the general level of prudent management, is likely to have been a contributory factor.*
>
> *Another possible indicator of the effectiveness of the entry prerequisites for approved trustees is that considerable voluntary contributions continue to flow into public offer entities and small APRA funds .... This may be a measure of the confidence of consumers in the prudent management standards, as well as the advantages afforded by the taxation concessions available to superannuation savings".*

We would like to observe that, despite the absence of an "Approved Trustee", there have been few, if any, failures of either corporate funds or of non-public offer industry funds. Typically, these funds are not managed by approved trustees.

Accordingly, we would query the validity of the conclusion that "*the statutory requirements imposed on approved trustees, together with the attendant improvement in the general level of prudent management*" is likely to have been a significant contributory factor.

We would also suggest that the fact that "*considerable voluntary contributions continue to flow into public offer entities and small APRA funds*" may be attributable to a number of factors other than a perception of "*the effectiveness of the entry prerequisites for approved trustees*". In fact, we would go as far as to suggest that the vast majority of consumers who make such voluntary contributions would be unaware whether or not the trustee of the superannuation fund is an approved trustee.

One of the major reasons why voluntary contributions are made to public offer funds is simply because they can be - self-employed persons are generally only able to contribute to public offer funds. Similalry, if employees chose to contribute to a fund other than the one to which their employer contributes then they, too, can only contribute to a public offer fund, which will, by definition, have an approved trustee.

Contributions to small APRA funds are generally made by "mums and dads" and small business owners who wish to retain a degree of control over the specific assets into which their superannuation contributions are invested. There are a number of products on the market which offer the contributor the ability to effectively nominate where their contributions are invested.

This is not to say that voluntary contributions are, in some part, due to *"a measure of the confidence of consumers in the prudent management standards"* of the superannuation industry as a whole. We would suggest, however, that the most significant factor is likely to be *"the advantages afforded by the taxation concessions available to superannuation savings"* in the absence of any substantial "crisis of confidence" a bout the management of the superannuation industry.

In other words, consumers tend to assume that an industry is sufficiently regulated and supervised until such time as events prove otherwise. One example of this would include the amount of money invested in unlisted property trusts in the early to mid-eighties. More recently, ASIC has demonstrated, as part of its "Gull Awards", that it was able to post an entirely fictitious offer on the web to which a considerable amount of money was subscribed.

Under the heading **"Possible scope for improvement"** at Page 43 it is stated: -

> *"Among the entry requirements for approved trustees, participants identified the capital adequacy and liquidity requirements as providing scope for improvement".*

Further down: -

> *"The issue is whether a NTA, given the other entry requirements, adds much, in its own right, to prudent management, or instead adds unnecessarily to approved trustee costs. Compared with some of the other entry requirements — for example, the custody requirements, liquidity requirements, contingency plan, insurance requirements and disqualified person test — a NTA requirement may not address as directly the characteristics or skills which make a 'good' trustee.*
>
> *On the other hand, a NTA requirement increases the likelihood of prudent management, but the present arrangements are inadequate".*

One observation with respect to the NTA requirements is that their application is anomalous when it comes to the distinction between those funds which utilise a custodian and those which do not.

To waive the NTA requirements in respect of the former but not the latter implies that the risk which is being safeguarded against is that of loss of the assets which are held custodially. In reality, there are a number of risks other than that of loss of investment assets, not the least of which would be a failure of the administrative system or procedures.

The requirement for a trustee of a not-for-profit fund, such as an industry fund or a corporate fund, to have its own capital must be questioned.

Generally, such functions as the administration of the fund is outsourced and the trustee secretariat performs an overseeing management role. A more suitable alternative to the requirements to have an NTA would be to mandate sufficient levels of suitable insurance cover to be held by the trustee.

Further down on Page 43 it is stated that: -

> *"The case for a change in the NTA requirement rests on two premises. First, ... there is a direct link between such requirements and the likelihood of prudent management. Without such a requirement the risks associated with deficient trusteeship would be higher".*

The requirement to have a prescribed level of NTA does not necessarily increase the likelihood of prudent management.

In the one hand, the existence of a certain level of NTA may bring with it commercial pressures to increase the effective rate of return on such capital which has been effectively "tied -up" in the business. In certain circumstances, such commercial considerations may be in direct conflict with prudent management.

Examples of this include the UK experience, where consumers were mislead into losing what in some cases were considerable pension entitlements to acquire an interest in rival, commercially operated schemes. Similarly Chile has experienced the phenomenon of "churning", where consumers are repeatedly enticed into switching between similar products, with the only gain falling to commission based sales persons.

Conversely, prudent management can be achieved by alternate means. One, which has seen the Australian superannuation system recognised internationally as an example of an "ideal" or "best practice" model, is that of equal representation of member representatives and employer representatives upon the board of directors of the corporate trustee. This, coupled with the requirement for a two thirds majority, ensures a balancing of competing considerations and an internal "watchdog" involved in the decision-making process at the board room table, which has proven an effective mechanism.

Another means of achieving prudent management is to have system which mixes self-assessment with both internal, external and regulatory audit against legislatively imposed standards and which imposes appropriate sanctions. Arguably, the current SIS regime is a reflection of this model, although there is room for improvement with respect to the regulator's ability to adequately supervise and impose sanctions in particular.

On page 44 APRA is cited as stating that: -

> *" 'problems still arise and some of the most serious — involving large numbers of small funds managed by approved trustees — have been observed in recent times' (sub. 36, p. 4)".*

It would appear that, empirically at least, there is a distinction to be made between those approved trustee "*involv[ed in managing] large numbers of small funds*" and those which manage a small number, generally one, large fund, such as an industry fund.

While the latter are generally run on a "not-for-profit" basis, the former are generally driven by commercial considerations to design a product which enables then to be receptive to the requests of their investors. Accordingly, in some of these arrangements, the consumer \ investor is effectively managing their own portfolio.

Further down Page 44 it is stated: -

> *"only 56 trustees were approved on the basis of having at least $5 million NTA (or equivalent form) in their own right (sub. 49, part 3). Nearly all of these are approved trustees of small APRA funds. While the Act enables approved trustees to have less than $5 million NTA (or equivalent form) if they place custody of the assets with an independent custodian, the use of this arrangement is perhaps more widespread than envisaged or desirable".*

With respect to approved trustees of a single large public offer funds, there is no reason why it should be considered undesirable to mitigate against the risk of loss of investment assets by placing the custody of such assets with an independent custodian. The risk of such occurrences as the failure of the administrative system or other procedures, which may be outsourced, could then be covered by insurance.

The draft report then goes on to state that: -

> *"The Commission considers that there is a case for amending the capital adequacy requirements for approved trustees. There has been extensive use by these trustees of the custodial concession and, following eight years' experience, there is reason to believe that it may not suffice for such trustees to be approved on the basis that they use a custodian having $5 million NTA. The approved trustee, as the responsible entity, should have some 'substance' in its own right.*

One option therefore would be to require in legislation that all approved trustees have a minimum NTA (or guarantee or combination of NTA and guarantee) themselves, rather then being able to rely on use of a custodian which meets the $5 million capital adequacy requirement. This option could still allow those who use an external custodian to have a smaller NTA than the existing $5 million requirement".

We would argue that, in circumstances where the approved trustee has delegated a number of the functions to third party providers and is itself performing a management function, little is to be gained by compelling the trustee to meet a NTA requirement. Indeed, in such circumstances this may in fact be quite anti-competitive, raising a barrier to entry and granting an unfair advantage to approved trustees which are part of a financial institution (generally of "retail" products) at the expense of approved trustees of "not-for-profit" industry funds.

The draft report then goes on to state that: -

> *"An alternative to legislation would be to allow APRA to determine an approved trustee's capital adequacy as part of a revised instrument of approval. The Commission prefers, however, the use of legislation in order to have clearly specified requirements and to reduce uncertainty among those who wish to be approved trustees.*
>
> *The appropriate size of the minimum NTA for approved trustees would need to be assessed carefully. There are two categories of approved trustees — those with at least $5 million NTA (or equivalent) and those that do not and instead rely on an independent custodian that does have at least $5 million NTA. The latter group of approved trustees should, in the Commission's view, be required to meet a minimum NTA (of, for example, $2 million). There may also be a need to set the requirement for the former group at a level higher than $5 million, given that inflation has reduced the real value of the $5 million by about 20 per cent".*

While we generally are of the view that the use of legislation is preferable *"in order to have clearly specified requirements and to reduce uncertainty"*, as there is considerable potential for this to produce anti-competitive results it may be preferable for APRA to determine each case on its merits.

Accordingly, we disagree with **DRAFT RECOMMENDATION 4.1** as follows: -

> ***The net tangible asset requirements for approved trustees should be strengthened through legislative amendment. All approved trustees should be required to have a specified minimum amount of net tangible assets (or approved guarantee or combination thereof) regardless of their custodial arrangement. Approved trustees who use custodians should not be required to have more than the specified minimum amount.***

We agree with Finlaysons when, as stated at Page 45 to 46, they

> *"on the basis of a comparison of the entry requirements for approved trustees and those for not-for-profit employer-sponsored funds, questioned the objective or effectiveness of condition D1 in the APRA draft instrument of approval — namely, that an approved trustee is required to use an independent custodian, must maintain at all times eligible assets of at least $100 000 and liquid assets of at least $100 000:*
> *"... trustees of corporate funds usually have only a small, or token, amount of assets. As the duties for a corporate fund and a public offer fund are largely the same ... it is difficult to see how an additional asset requirement for Approved Trustees could possibly relate to their ability to perform their duties as a trustee. (sub. 17, p. 3)"*

It is stated at Page 46 that: -

> *"The Commission considers that there is a need for all approved trustees to have adequate liquidity and working capital in order to fund operational requirements and to cover the risk of operational failures. While the instrument of approval of approved trustees requires a certain amount of eligible and liquid assets, these amounts need to be reformulated so that they reflect operating expense levels and appropriate provisioning for replacing record keeping systems and deal with other contingencies. Given the importance of these prudential requirements, they should apply equally to all approved trustees which do have at least $5 million NTA and should be recognised in the legislation.*

Again, we would consider that where the approved trustee of a not-for-profit industry fund has outsourced their administrative functions, the requirement *"to have adequate liquidity and working capital in order to fund operational requirements and to cover the risk of operational failures"* lies with the administration company. Consideration could be given to mandating suitable insurance in lieu of a requirement for operating capital.

Accordingly, we disagree with **DRAFT RECOMMENDATION 4.2** as follows:

The operating capital requirements for all approved trustees should be revised, through legislative amendment, so that they represent a specified proportion of an approved trustee's operating costs.

It is stated under "**4.2 - Custodians**", under the heading "**Objective**" on Page 49 that: -

> *"Reduction of these risks is important for the prudent management of superannuation entities. The requirement is for institutions which provide custodial services for superannuation assets to be sound. It also underlies APRA's set of 'best practice' benchmarks in custodial arrangements that are voluntary for not-for-profit trustees, but mandatory for approved trustees".*

It should be noted that whether a trustee is "not-for-profit" does not determine whether it is an "approved trustee". While the trustees of industry funds and corporate funds are "not-for-profit", those trustees of "not-for-profit" industry funds which are public offer have to be an approved trustee.

Chapter 5 deals with **"The SIS legislation: Compliance Cost Concerns - Requirements governing operations of superannuation entities"**. The initial provisions considered are the **"Contributor Status and Payment Standards"**.

The **"Assessment"** with respect to **"Contributor Status"**, at Page 62, states as follows: -

> *"Contributor status provisions (in isolation) serve an important purpose in ensuring that concessionally taxed superannuation savings are used solely for retirement benefit purposes. Current age limits and the associated requirements of the legislation, however, appear to impose significant compliance costs on particular funds, which raise their administration costs, as well as on their members. The present requirements do not seem to pay adequate attention to a number of relevant matters.*
>
> *These include increases in life expectancy and labour force participation for persons aged over 65; the compliance costs associated with frequent monitoring of employment status; the anomaly created by eligible spouse provisions; and the existence of other legislative provisions which prevent excessive use of tax concessions (such as reasonable benefit limits and age-based maximum deductable limits). This suggests that there is scope to reduce these costs without compromising the purpose of the legislation, with benefits for fund members and from a community-wide perspective".*

The introduction of spouse contributions has severely weakened the occupational nexus, as the eligibility to enable a spouse contribution to be made is simply whether the parties are living together as husband and wife, irrespective of either party's employment status. Not only has this weakened the occupational nexus, it could also be considered discriminatory in that parties in a heterosexual relationship are treated differently to persons either not in a relationship or in a homosexual partnership.

Furthermore, not only are contributions allowed to be made into the concessionally taxed environment, but in certain circumstances the contributor is entitled to a rebate – a further tax concession.

Further to this, the implementation of the Family Law and Super provisions next year may create fund membership for "ex-legal spouse" members. These members may also never have worked, and may no longer be in a marital or de facto relationship, but will nevertheless, as a result of their membership of a super fund, be the recipient of concessional tax treatment. By way of contrast, a non-employed party to a de facto relationship, where there is no legal jurisdiction to split the superannuation interest of the employed partner, may be unable to join a superannuation fund.

Presumably the policy with respect to allowing spouse contributions and enabling the split of superannuation interests upon marriage breakdown was in recognition of the fact that non-employed persons need to make provision for retirement in the same way that employed person do. Given the increasing trend in the breakdown of relationships, there is an even stronger case to recognise the retirement income needs of non-employed persons.

Historically there was a concern that higher net worth individuals would be able to secrete significant amounts of money in superannuation, thereby availing themselves of concessional tax treatment with respect to the income and realised capital gains on their superannuation investments. There was a perception that superannuation would be utilised as an estate planning mechanism, whereby the assets, and sometimes even the income, would not be used in retirement but instead would be handed down to the next generation.

Developments in this area, including the refinement of the Reasonable Benefit Limits ("RBL"s), especially with respect to death benefits; the abolition of the "averaging method" for maximum deductible limits and, in particular, the introduction of the surcharge, have reduced both the tax effectiveness of superannuation. This in turn has reduced the potential scope for "rorting" the tax concessions afforded to superannuation.

If there is a concern that there is potential for persons to contribute excessive amounts of voluntary, member undeducted contributions, perhaps consideration could be given to either imposing a maximum amount per person per year or developing a form of RBL measurement to account for undeducted contributions.

With respect to labour force participation, it should be noted that it was a policy initiative of the current government a couple of years ago to encourage employees to remain in the workforce by paying them a bonus related to the period of employment after the notional retirement age.

Under "**Payment Standards - Compulsory Cashing of Benefits – Costs**", on Page 64, it is stated that: -

> *"Anomalies (similar to those in contributor status provisions) also exist in the monitoring requirements for employment status".*

One such anomaly arises as a consequence of the interaction of mandatory contributions and the compulsory cashing conditions.

Initially retirement income policy was such that benefits were simply to be cashed at "retirement age", generally age 65. Concessions were then allowed to permit deferral of payment, provided the person were still employed (this is reflected in the current provisions, with the requirement becoming more onerous upon attaining age 70).

Meanwhile, the contribution standards allow voluntary contributions to be made between age 65 and 70 provided the person is employed on at least a part-time basis (10 hours per week) every week. Mandated contributions (either award \ workplace

agreement or made under the Superannuation Guarantee legislation) can be accepted irrespective of age and the number of hours worked.

Even before the age when Superannuation Guarantee contributions cease was increased from age 65 to 70, award \ workplace agreements frequently required the payment of contributions beyond age 65. Avoiding the phenomenon whereby the superannuation account was effectively conducted as a "bank account", with money contributed one day available for payment the next, necessitated the creation of the concept of "post 65 employer mandated contributions".

As a consequence, funds are now presented with the possibility that a member aged 65, for whom they are receiving current contributions, both mandatory and voluntary, fails to work 10 hours one week. This would result in the fund being unable to accept the voluntary contributions (although mandatory contributions must still be accepted) and requires the compulsory cashing of the members benefit *other than the post 65 employer mandated benefit*. Quantifying the amount of the *post 65 employer mandated benefit* can often prove problematic, as systems were frequently not designed to accommodate this calculation.

If the member resumes gainful employment on at least a part time basis, then voluntary contributions can resume (until age 70) and arguably, on policy grounds, there was no need to make the payment of the benefit (which could even be re-contributed as a voluntary, member undeducted, contribution).

We would suggest that, given the existence of RBLs, age-based maximum deductible limits and the surcharge (subject to the qualification with respect to undeducted contributions discussed previously) consideration should be given to: -

- allowing all contributions until age 65, irrespective of employment status;
- allowing contributions between ages 65 and 70 provided employer contributions are being made;
- allowing mandated contributions only after age 70; and
- deferring compulsory cashing of benefits until employer contributions have ceased.

Under the heading "**Assessment**" on Page 65 it is stated that: -

> *"Payment standards provide important benefits by preventing excessive use of available taxation concessions. The compulsory cashing and preservation elements of these standards also appear to involve significant compliance costs. Given the requirement to monitor employment status for the contribution standards described above, the same (but not additional) costs are involved in monitoring employment status for compulsory cashing requirements".*

We would dispute that the same, but not additional, costs are involved in monitoring employment status for compulsory cashing requirements as are required for the contribution standards. By definition, funds need only concern themselves with members in respect of whom a contribution is being made - a sub-set of all members.

For standard employer-sponsored funds, be they public offer or otherwise, the majority of contributions are received from employer sponsors. In the circumstances, it would be reasonable to accept that the person in respect of whom the contributions are received is in employment.

As the nexus with employment is all that is required, this of itself is sufficient for members aged under 65. For members aged between 65 and 70, the only issue is whether they are in gainful employment for at least 10 hours per week, unless the contribution is otherwise mandated. Once a member has turned age 70, all voluntary contributions must cease and the only question s whether the employer is contributing in excess of mandated contributions.

When it comes to the compulsory cashing conditions, however, the scenario is different. Given the increasing trend in the rate of changing employment and broken working patterns for other reasons, coupled with compulsory preservation of the majority of benefits, at any time a number of members of a fund are not in receipt of contributions.

Accordingly, when members turn age 65, they may or may not be in receipt of contributions. Members who are in receipt of contributions may nevertheless not be working sufficient hours every week to defer compulsory payment. Conversely, members who not in receipt of contributions may in fact be gainfully employed sufficient hours but either super contributions are not being made (eg self-employed) or they are being made to another fund.

As a consequence, the compulsory cashing conditions which necessitates funds contacting all members aged 65 and over on a regular basis to ascertain their employment status. Those working insufficient hours must claim their benefit (except, as indicated above, any "post 65 employer mandated benefit") whilst those working the requisite number of hours are permitted to retain their benefit in the fund.

Accordingly, we agree with the objective of **DRAFT RECOMMENDATION 5.1** as follows: -

> ***"Age and employment requirements governing contributor status and compulsory cashing of benefits should be simplified. In particular, consideration should be given to treating members aged between 65 and 70 in the same manner as those under 65, provided there are no substantial implications for taxation revenue.***
> ***The monitoring of employment status should be clarified with a view to reducing its frequency; alternatively, responsibility to provide the required information should be placed on members, with appropriate penalties for non-compliance".***

Under the heading "**Benefit Protection**" on Page 65 the following statement is made: -

> *"Standards relating to the protection of member benefits, protect small account balances and lost member accounts from erosion by administration costs".*

We would make the observation that, whilst small account balances are protected against erosion by administration costs, in fact lost member accounts over $1000 can in fact be protected against investment performance, surely an unintended outcome.

Under the heading "**Small account balances**" on Page 65 the statement is made that: -

> *"Trustees can choose, at the end of a member reporting period, to protect the member's balance within their own funds"*

It should be noted that, in addition to the end of a member reporting period, a member's balance must also be protected upon exit from the fund.

Further down it is stated that: -

> *"Where no suitable ERF can be found, the trustee may transfer small accounts into the Superannuation Holding Account Reserve (SHAR) operated by the ATO".*

It is in fact a requirement of being an ERF that they must accept all roll-overs and transfers-in and protect all benefits, accordingly, a suitable ERF can always be found. Trustees cannot transfer small amounts into SHAR - it is designed to only accept small contributions from employers who cannot find a suitable superannuation fund wiling to accept the contributions.

Under the heading "**Lost member accounts**", on Page 65 it is stated that: -

> *"According to APRA Circular I.B.1, members are considered to be 'lost' if, at a particular time, they are either uncontactable, inactive (for two years) or their benefits have been rolled over or transferred into another fund".*

For the sake of clarity, a member is considered to be "lost" if they are inactive **and the trustee has not verified their address** or their benefits have been rolled ver or transferred to another fund **as a lost member**.

On Page 6 it is stated that: -

> *"As with small accounts, trustees may transfer lost member accounts into an ERF, after the required steps to locate the lost member have been undertaken".*

The trustee is not required to take any steps to locate a lost member before they are transferred into an ERF. It is a requirement that the trustee advise members on joining of their policy with respect to transferring members to an ERF, the circumstances in which it is likely to occur (including becoming lost) and disclose the name and contact details of the ERF it has selected to use.

It is then stated that: -

> *"There are currently around 4 million accounts on the Lost Members Register (which represents around 18 per cent of total superannuation accounts) containing around $5.5 billion in funds. This represents an average of close to $1400 per account".*

The legislation requires that, in respect of a "two-year inactive member", that their address must be positively verified. As past efforts to write to members at their last known address, requesting that they confirm their address is correct, have proven expensive, futile and to have provoked angry responses from members, funds may have a number of "two-year inactive" members for whom they have not verified their address. As such, these members are technically lost.

As the ATO file specifications do not specify a field to distinguish between members who are lost through returned mail and those who are "two year inactive" without a verified address, it is impossible to gauge hoe many lost members fall into each category. As a number of two year inactive members are well aware of where their superannuation is located, and have not moved house, these figures could be considered an overstatement of the position with respect to members who have genuinely lost contact with their superannuation monies.

It is stated under the heafding **"Objective"** on Page 66 that: -

> *"The objective of the standards is the protection of fund members' benefits. This is achieved by preventing the erosion of small and lost member accounts which would occur as a result of administration charges exceeding investment returns in any given period. These standards are based on the view that the erosion of small or lost member accounts through administration charges is unreasonable from a community-wide perspective. The financial benefits of the standards accrue to the holders of these small or lost member accounts".*

As stated above, whilst small accounts are protected by "preventing the erosion ... which would occur as a result of administrative charges exceeding investment returns in any given period", lost member accounts in excess of $1000 generally only require protection in periods of extremely low or negative returns. Accordingly, what lost member accounts are in fact being protected against is poor returns.

Under the heading **"Assessment"** on Page 68, it is stated that: -

> *"Participants are invited to provide information on the extent of use of roll-over provisions in order to reduce compliance costs associated with administration of small balances and lost members. Information on other means of reducing these costs would also be welcome".*

Trustees use the roll-over to an ERF provisions fairly extensively to reduce the incidence of the number of **small and inactive** member accounts requiring protection, and accordingly minimising the cost impact upon the fund. It should be noted, however, that this is not in the way of reducing the costs of creating a regime which ensures compliance with the legislation.

Where an account is **small but is still active** (ie contributions are being received into it) then the option of rolling-over the account to an ERF is not available to the trustee. This can occur either when it is relatively early in the period of fund membership, or when the level of contributions being made is small or the amount in the member's account is being reduced significantly by insurance premiums.

When a member's account is **active but the member is lost,** because while the account is in receipt of employer contributions, mail has been returned, then again the trustee does not have the option to roll-over the account into an ERF.

If the member is **two year inactive but the account balance is over $1000** then generally the trustee will not roll-over the account to an ERF as it would normally be self sufficient except in years of extremely low or negative returns.

Two possible means of reducing these costs would be: -

- to no longer require the protection of lost member accounts in excess of $1,000; and
- given the long-term nature of superannuation and the existence of preservation, to increase the period of inactivity from two years to say seven.

Under the heading **"Non-resident benefits"** at Page 69 it is stated that: -

> *"There appear to be two reasons for requiring SG contributions for non-resident employees. First, a single uniform requirement that all employees be subject to SG provisions is simpler than having different rules for different categories of employees, which may prove complex to administer (for example, requiring identification of a bona fide non-resident short-term employee). Second, failure to impose SG provisions on non-resident short-term employees might create a bias in the labour market as employers switch away (where possible) from higher cost (due to the SG) domestic labour".*

It is our understanding, from statements made by the executive arm of government (either the ATO or the Department of the Treasury) around 1993 with respect to touring performing artists and sportspersons, that it was the second reason which was paramount for requiring SG contributions for non-resident employees.

Under the heading **"Assessment"** on Page 70 it is stated that: -

> *"The preservation of small account balances for bona fide non-resident employees involves compliance costs similar to (if not greater than) those for small and lost member accounts. Consideration could be given to modification of the present requirement so that bona fide non-resident employees could be allowed to repatriate superannuation benefits from Australia up to a specified small limit".*

We agree with this and accordingly support **DRAFT RECOMMENDATION 5.2** as follows: -

> ***Restrictions on access to (or transfer of) superannuation benefits of bona fide non-resident short-term employees should be simplified in order to reduce compliance costs. These benefits should be able to be repatriated if they do not exceed a specified small limit.***

Chapter 6 is **"The SIS legislation: other provisions under review"**. Under "**6.1 Trust and trustee requirements, A trust focus"**, under the heading **"Assessment"** at Page 83 it is stated that: -

> *Trusts are perceived to be highly suited to, and to have worked well in, ensuring the prudential management of superannuation entities."*

We strongly support this contention and, accordingly, endorse the first sentence of **DRAFT FINDING 6.1** that: -

> *"The trust basis of the legislation is effective in facilitating prudent management of superannuation entities".*

Under **"Trustee representation"** under the heading **"Assessment"** on Page 85 it is stated that: -

> *"The equal representation rules seek to foster the prudent management of standard employer-sponsored funds by trustees representing the interests of all fund members.*
>
> *In particular, trustees - who include members with an interest (or holding) in the fund - are likely to have greater incentive than more 'arm's length' trustees to ensure that decision making with respect to the fund reflects members interests."*

On Page 86 it is stated that: -

> *"Also, the appointment of members as trustees may diminish the potential for fraud and malpractice that might otherwise occur, as members are more likely to be vigilant in overseeing the fund."*

Further down it is stated that: -

> *"The equal representation rules may also lead to greater confidence by members in their trustees."*

We agree with all of these statements. Accordingly, we concur with the **DRAFT FINDING 6.2** as follows: -

> *"The equal representation rules for trustee boards of standard employer-sponsored funds provide balanced representation of employer and employee interests. They are conducive to active member interest in the prudent management of these funds.*
> *This benefit exceeds the cost of finding and appointing members who are capable of undertaking trustee duties".*

Under **"Application of the Criminal Code and strict liability to offences"**, under the heading **"Assessment"**, at Page 89 it is stated that: -

> *"Stronger penalties for contravention of the SIS legislation can improve the incentives for compliance by trustees (both individuals and corporations) and, thus, contribute to improved prudent management. In particular, strict liability offences enable APRA to enforce compliance by trustees with the SIS legislation more effectively by reducing the evidential burden it must show to prove a prima facie case of breach."*

We endorse these observations.

It is stated under **"6.2 Requirements governing operations of superannuation entities - Sole purpose test"** at Page 90 that: -

> *"The provision of benefits by regulated superannuation funds is limited by the sole purpose test to a number of specified core or ancillary purposes* ***related to the provision of retirement incomes*** *(sec. 62, regs. 1.03 and 13.18)" (emphasis added).*

Accordingly, we would query the provision of benefits upon death as being a "core purpose" as not being consistent with this stated aim. This has enabled the existence of "death benefit only" funds, a "risk only" product, where the right to receive a benefit ceases upon retirement age, which serves to ensure that a retirement income is not in fact provided.

It is stated under the heading **"Assessment"** at Page 92 that: -

> *" Concessionally taxed superannuation assets and contributions are designed to provide for retirement benefits. Thus, limiting the types of core and ancillary services provided by superannuation funds to those related solely to the provision of retirement benefits is consistent with this objective.*
> *While the test might appear to be overly restrictive in prohibiting certain services, there is a risk that extending the range of services provided may weaken its key objective. This could occur both through increased uncertainty as to the limits of what may be provided and through the interaction of the sole purpose test with other provisions in the SIS legislation, such as those relating to successor fund transfers (see below). Moreover, the types of additional services sought by some participants (such as financial advice and home loans) are readily available through a range of commercial providers".*

We concur with the above statements.

Accordingly, we support **DRAFT FINDING 6.5** as follows: -

> ***"The sole purpose test, which restricts the range of services that superannuation funds can provide to their members, is necessary to achieve retirement incomes policy objectives and should be retained".***

Under the heading **"Successor fund transfers"** under the heading **"Assessment"** at Page 93 it is stated that: -

> *"There is some uncertainty about the definition of equivalent rights. Consequent problems may arise as trustees from both the successor and original fund attempt to reach agreement on the transfer of member benefits. (If the original fund has a number of ancillary purposes, agreement may be even more difficult.) On this general point, several participants noted that successor fund provisions had generated confusion within the superannuation industry and, as a consequence, required costly legal advice to clarify the provisions".*

We agree with the above statement, with the one qualification to the effect that it is not the "successor fund provisions" per se which have generated confusion, but specifically the concept of "equivalent rights".

Accordingly, we agree with the following statement on Page 94: -

> *"It would appear that there is a good case for maintaining successor fund transfer provisions in order to provide a cost efficient means of transferring a group of members between funds in certain prescribed circumstances. The safeguard built in to the legislation of equivalent rights being provided to members is also warranted given that the members' right to consent is waived.*
>
> *The adequacy of the definition of equivalent rights and the extent to which this continues to create uncertainty and unnecessary costs to regulated superannuation funds are unclear as APRA has only recently issued a circular seeking to clarify the definition. Further clarification of the definition may help to reduce the time taken, and costs incurred, by trustees of the new and old funds in reaching agreement on whether the successor fund provisions have been met and for transfers to proceed".*

As a consequence, we endorse **DRAFT FINDING 6.6** as follows: -

> ***"The successor fund provisions are appropriate, although some improvement in their application appears to be required. In particular, the definition and application of equivalent rights needs to be clarified further. The question of whether the provisions can be abused by employers seeking to avoid their obligations, and the need to introduce administrative changes to guard against this, require further investigation".***

Under **6.3 Investment rules** under the heading **"Assessment"** at Page 99 it is stated as follows: -

> *"The possibility of insufficient diversification of investments by a minority of superannuation entities is, in the first instance, an enforcement matter rather than a weakness in the current law requiring change. The great majority of entities comply with the existing law and guidelines. APRA appears to have a clear idea of the type of entities that are not diversifying to the extent it considers prudent. This implies that if members' contributions are currently at undue risk, the quickest and most cost-effective remedy is likely to be immediate, direct interaction between APRA and the entities of concern. APRA acknowledged that 'this will inevitably involve APRA in fine judgement about whether certain assets or portfolios are appropriate, often while those assets are still performing satisfactorily' (sub. 36, p. 9). Changing a 'concentrated' portfolio to a diversified one may result in bringing to account book losses on assets which are over-represented in the portfolio.*
>
> *Revision of guidelines on investment, as proposed by APRA, would be a complementary measure which should help to bring about a change in some trustees' approach to diversification."*

We concur with the above statements with respect to enforcement.

Under **"6.5 Exemption of some public sector superannuation schemes**" under the heading **"Assessment"** at Page 104 the statement is made that: -

> *"The exemption enables the governments concerned to avoid a number of difficulties which they would otherwise face in bringing certain public sector superannuation schemes into full compliance with the SIS legislation.*
>
> *State and Territory government representatives indicated to the Commission that they generally espoused the continuation of the Heads of Government Agreement and the exemption of certain schemes from the SIS legislation. They cited several reasons, including sovereignty, continuation of certain existing member benefits, investment arrangements, while at the same time noting the strong prudent management and supervision arrangements applying to exempt State schemes".*

The statement of reasons to the effect that "the continuation of certain existing member benefits [and] investment arrangements" implies that these benefits and investment arrangements would not be permitted if the scheme were to come under the SIS legislation. As a matter of equity, it should be questioned why such benefits and arrangements are available to one class of superannuation funds members whilst being denied to another class of members.

At Page 106 it is stated that: -

> *" ... it may be desirable that the current list of exempt schemes does not expand. Indeed, consideration could be given by governments as to whether open exempt schemes could be closed or made more consistent with the SIS legislation".*

Rather than not expanding the current list of exempt schemes, or closing existing schemes to new members, consideration could be given ensuring enhanced consistency with the SIS legislation by ensuring that the provisions enunciated in the Heads of Government Agreement more closely align with the SIS provisions.

Accordingly, we do not agree with **DRAFT RECOMMENDATION 6.1**, namely that: -

> ***"There should be no expansion of the current list of exempt public sector superannuation schemes. Consideration should be given by governments to the feasibility of closing exempt schemes which are open to new members. Any new schemes should be subject to the SIS legislation".***

Under "**6.6 Administration - Division of responsibilities**" under the heading "**Assessment**" at Page 109 is stated **DRAFT FINDING 6.7** as follows: -

> ***"It would be desirable that APRA and ASIC continue to improve coordination of their activities, such as site visits, with a view to reducing the additional costs which have arisen following changes in the administrative arrangements for the SIS Act".***

We concur with this draft finding. We make the observation that, if APRA and ASIC were to collaborate more extensively on both a formal and informal basis, including such measures as co-operating in the development of policy; legislative interpretation and application, and in enforcement, they would benefit greatly from the shared experience. In particular, measures such as staff exchanges and joint working groups facilitates a sharing of "corporate memory" between the regulators and can produce a greater awareness and understanding of the underlying policy objectives.

Under "**Guidance material and general education**" under the heading "**Assessment**" at Page 112 it was stated that: -

> *"To minimise any potential costs associated with circulars, it is important that mechanisms for development of circulars and consultations are effective and efficient. This is particularly important if the circular is of a quasi-regulatory nature".*

We agree with this statement and would encourage the development of a semi-formal process of consultation with industry.

Under **"7 Modifications to the SIS legislation"** at Page 116 it is stated that: -

> *"Improving the cost-effectiveness of the legislation could involve:*
> - *pursuing the objectives of the legislation more effectively — for example, by ensuring that the legislation targets better the relevant prudent management and prudential supervision problems associated with superannuation entities; and*
> - *reducing compliance and other costs imposed on superannuation entities and their members — for example, by reducing the complexity and prescription of the legislation, reducing legislative duplication, and increasing competition within the superannuation industry.*
>
> *Of these specific aims, reducing the complexity and prescriptiveness of the SIS legislation is likely to bring the greatest benefits to members of superannuation entities and the wider community. The Commission's analysis suggest that the legislation contains only a few minor unwarranted restrictions on competition, whereas complex and prescriptive requirements are the main cause of additional compliance costs for superannuation entities".*

While we support the contention that the legislation should better target the relevant prudential management and supervision problems associated with superannuation entities, we would consider this to be more in the way of ensuring that the legislation achieves its intended objectives, as opposed to minimising costs.

We agree that reducing the complexity of the legislation and ensuring that differing legislation is consistent would certainly minimise costs, however, prescriptiveness can, in certain circumstances, also serve to improve the cost effectiveness of legislation. Provided the prescription does not lead to unintended consequences when applied to unanticipated circumstances, in promoting regulatory certainty it can actually result in minimising compliance costs.

Under **"7.1 Option 1 — improve specific areas of the legislation"**, at Page 117, a number of amendments to the provisions of the SIS legislation were suggested. Of the suggested improvements to the SIS legislation, the more beneficial recommendations which should be given priority include: -

- simplifying:-
  - age and employment requirements governing contributor status and compulsory cashing of benefits;
  - restrictions on access to (or transfer of) superannuation benefits of bona fide non-resident short-term employees;
  - lost member and member benefit protection provisions;
  - the definition and application of "equivalent rights" in successor fund transfers.

Under **"7.2 Option 2 — introduce an effective 'licensing' arrangement"** at Page 119 it is stated that: -

> *"The introduction of an effective licensing arrangement for all superannuation entities (both existing and newly created entities) would help to overcome perceived weaknesses in the existing entry requirements contained in the SIS legislation in achieving prudent management and prudential supervision objectives.*
>
> *Although the details of such an arrangement would need to be developed carefully, and may require amendments to the legislation, it could involve the following features:*
> - *a superannuation entity must be licensed by APRA if the entity is to be regulated under the SIS legislation and be eligible for special taxation treatment;*
> - *the application for a licence must be made by the trustee(s) of the entity;*
> - *APRA must license the entity once certain specific conditions are satisfied by the trustee;*
> - *periodic licence renewal (to ensure that the entity continues to meet the licensing conditions); and*
> - *provisions for revoking the licence (for example, if the entity fails to comply with its licence conditions or other requirements of the legislation)".*

We submit that a licensing regime would not prove an effective use of resources to achieve prudential supervision of the industry, especially given its size and diversity.

Utilising the analogy of driving licences, it is recognised that, while an initial examination as to fitness to drive is essential, problems such as increases in the road tolls are not addressed through the licensing process but instead through a combination of amending the road rules (regulation) and enhanced enforcement. A person can obtain a (provisional) licence at the age of 17 or 18 and, barring disqualification for breaches of the road rules, renew their licence automatically every few years until the age of 80.

Instead of utilising the licensing process, a problem such as an increase in the number and severity of collisions is addressed by such measures as reducing speed limits, reducing the blood alcohol limit and mandating the wearing of seat belts (regulation) and through education campaigns. If there is a perception that the road rules are not being adhered to, again this is not addressed through the licensing process but instead through enforcement by, for example, increasing the use of radar detection, random breath testing and red light cameras and through education.

Similarly, the legislation should be amended to ensure that compliance will enhance prudential management and the regulators should be resourced with the necessary supervisory tools and powers of enforcement.

In particular: -

- it should be sufficient that there is legislation with which the trustee must comply;
- the trustee is frequently an corporate entity, whose decisions are made and actions are performed by its directors and officers, who may be dominated by one individual and which can change in composition at any time. Accordingly, granting a licence to a corporate entity is less effective than licensing of individuals;
- if "APRA must license the entity once certain specific conditions are satisfied by the trustee" then this ensures a "rubber stamp" process that adds little more than a "self assessment and certification with regulator audit" regime would achieve;
- similarly, while periodic ensuring that the entity continues to meet the licensing conditions is desirable, this does not have to take the form of a "licence renewal"; and
- provisions for revocation of complying status or removal and substitution of the trustee already exist, and these should be supplemented with a regime of enforcement and penalties imposed directly upon the trustee.

Further down Page 119 it is stated that: -

"The licensing conditions could require, for example, that the trustees:
- *meet certain requirements regarding their capacity to manage the entity;*
- *ensure the entity has certain minimum operating capital;*
- *provide an investment strategy; and*
- *use an independent auditor as well as an ASIC-approved dispute resolution body".*

Imposing conditions as to trustee capacity, as indicated above, in practice may mean assessing individual directors and officers who may in practice have little or no say in the management of the fund or who may cease to act in their capacity the day after the licence is granted.

In addition, regard should be had to whether this may act as a deterrent, or effectively disqualify, persons from acting as member or employer representatives. Equal representation has proven an effective form of management and control of superannuation funds in Australia and has been acknowledged internationally as a desirable model.

There has never been a requirement under trust law that a trustee be an expert, instead, there is a recognition of the importance of "common sense" and an expectation that trustees will rely upon professional advice. This is analogous to the position with respect to the role of juries in trials, directors of corporations and executors of wills - there is no requirement for expertise, qualifications or experience.

In circumstances where the trustee outsources its administration there is no need to ensure that the entity have a minimum operating capital. Any operational risk could be mitigated by mandating insurance.

Any requirement to provide an investment strategy will see the development of "formulated" strategies which will be "trotted out" with the risk that the may be little real understanding or appreciation of the factors which must be considered. Of greater importance than the formulation of an investment strategy is ensuring that the trustee adheres to the strategy in setting its investment mandates or when making direct investments and ensures that investment managers observe their mandates.

Any requirement to use an independent auditor and an approved dispute resolution body could be contained in the legislation - they do not need to be imposed under licence conditions.

On Page 120 it is stated that: -

> *"Such conditions could vary according to the nature of the superannuation entity. For example, in relation to conditions applying to trustee capacity, individuals seeking to be trustees of employer-sponsored funds would need to satisfy a certain level of specified experience and qualifications. The conditions relating to corporations seeking to be trustees of public offer funds and small APRA funds could incorporate approved trustee requirements. The trustees of small self-managed superannuation funds could be exempt from conditions regarding their capacity, as they are the only beneficiaries of these funds".*

Imposing different conditions according to the nature of the superannuation entity can be achieved in the legislation itself, without the need for licensing.

Further down it is stated that: -

> *"Not only would this option assist in the more effective achievement of the legislation's prudent management and prudential supervision objectives, it would also help APRA to identify more satisfactorily the population of active and inactive superannuation entities".*

It is not readily apparent how licensing would assist in the more effective achievement of the legislation's prudent management and prudential supervision objectives, as this is best achieved through appropriately targeted legislation and supervisory activities.

What is required in order for APRA to identify more satisfactorily the population of active and inactive superannuation entities is an improvement in the process of lodging annual returns with APRA. Simply knowing the number of licensed drivers provides no information about road usage or the number of drivers who actually drive.

Further down Page 120 it is stated that: -

> *"A potential disadvantage of this option is that it could reduce the number of smaller employer-sponsored funds and, thus, competition in the industry. Because of potentially higher compliance costs imposed by the licensing arrangement, including the cost of capital, employer-sponsors may seek to transfer management of their funds to larger entities, such as retail and industry funds".*

This is a very real consideration. Non public-offer employer-sponsored funds, in the form of both corporate and industry funds, perform a valuable role within the superannuation industry and the loss of these funds would serve to further homogenise the industry.

Under **"7.3 Option 3 — remove duplication of compliance"**, under **"Life insurance companies"** at Page 127 it is stated that: -

> *"As noted in chapter 6, APRA and some other participants considered that, given the prudential requirements of the Life Insurance Act, the requirements under the SIS Act for a trust structure in life insurance companies achieve little additional purpose and create a misleading impression among members that they are receiving a 'level of duty' from trustees that does not necessarily exist".*

We would submit that, if the trustee is not providing a "level of duty" commensurate with their status as trustee and their trustee obligations, then this should be of concern to APRA as regulator. To accept that a "lesser" standard is permissible because the trustee is a related body corporate to a life office is not an acceptable position to adopt.

Further down it is stated that: -

> *"An option for reducing legislative duplication would be to remove the need for life insurance companies to comply with corresponding requirements in the SIS legislation. For example, APRA proposed that all superannuation assets in life office statutory funds be written by way of contracts between members and the life company, rather than by an interposed trustee".*

We would submit that, if all superannuation business in life office statutory funds were to be written by way of contract then, to the extent that this would lessen the duty owed to the member should not be allowed. In addition, it would have the effect of creating a distortion in the market in favour of life companies by lessening their compliance obligations and expenses relative to other providers of superannuation products.

Under **"7.4 Option 4 — revise the structure of the legislation"** at Page 128 it is stated that: -

> *"Specifically, APRA prosed that the 'retirement income aspects' be placed in other legislation and that a three-tiered legislative framework apply in respect of the prudential supervision of superannuation entities. The three tiers would consist of: -*
>
> - *an enabling Act setting out broad objectives and higher order principles;*
> - *'flexible, plain English' standard issued by APRA, which ,may be disallowable instruments by Parliament; and*
> - *explanatory guidelines that provide additional detail on the application of the standards(sub. 36, pp 6-7).*
>
> *This option has the potential to enable the legislation's objectives to be achieved more effectively. It would permit more flexible and timely regulatory responses to market-driven changes within the superannuation industry, as well as to the different risks associated with different superannuation entities. The process for changing standards or administrative documentation would be faster than the more formal process involved in amending an Act".*

It could be argued that there is already a "three-tiered" legislative framework applying in respect of the prudential supervision of superannuation entities, namely: -

- the SIS Act and regulations;
- the statutorily enabled power awarded to the Regulator to grant "exemptions" and make "modifications", which are disallowable instruments by Parliament; and
- explanatory guidelines which provide additional detail on the application of the standard, commonly in the form of circulars.

On Page 129 it stated that: -

> *"This option also could be seen as reducing complexity in the enabling Act by removing both existing retirement income policy provisions and prescriptive operational detail. However, it would not remove complexity so much as shift it to other legislation. Hence, there might be no real reduction in overall complexity or in compliance costs. Moreover, superannuation entities would no longer have their requirements contained in a single Act, which could complicate their compliance task.*

We concur with the above statement.

Further down it is stated that

> *"A potential disadvantage is that, by giving APRA increased discretion to determine standards, the option could contribute to greater uncertainty amongst superannuation entities, requiring them in some instances to have increased resort to legal advice about the standards. Moreover, it may not be ideal for a long-term superannuation investment to be subject to periodic discretionary changes in the standards. To guard against this, the exercise of discretion by APRA would need to be accompanied by extensive and robust public consultation, not only with trustees and others in the industry, but also with members of superannuation entities".*

Given the nature of the superannuation industry, its magnitude and diversity, and the prudential risks faced within the industry, it may be desirable to impart a degree of flexibility and discretion to the Regulator to enable it to react and respond appropriately to changing circumstances. Any such exercise of discretion should be made subject to Parliamentary or Ministerial scrutiny.

While "it may not be ideal for a long term superannuation investment to be subject to periodic discretionary changes in the standards", "extensive and robust public consultation" may not always be feasible or indeed desirable.

Accordingly, we agree with the first part of **DRAFT RECOMMENDATION 7.1**, namely: -

> ***"The SIS legislation should be amended to simplify certain complex requirements which impose significant compliance costs, to increase competition amongst providers of certain services to superannuation entities, and to enhance the effectiveness of capital adequacy requirements imposed on approved trustees. Specific proposals for change are contained in recommendations within chapters 4 and 5.***

We do not agree with the second part of **DRAFT RECOMMENDATION 7.1**, namely: -

> ***"In addition to these improvements, the SIS legislation should be amended to require that superannuation entities be licensed by the Australian Prudential Regulation Authority subject to specific conditions pertaining to such matters as trustee capacity, operating capital and the provision of an investment strategy. The Government and the Australian Prudential Regulation Authority should consult widely on the details of such a licensing arrangement".***

Under **"8 Superannuation (Resolution of Complaints) Act 1993"** under **"8.3 Benefits"** at Page 135 it is stated that: -

> *"In regards to the costs of complaints, the high cost of the court system would be likely to deter fund members from pursuing legitimate grievances, especially those with smaller claims. Such fund members are more likely to be those with smaller superannuation accounts as a result of their modest financial position or status as occasional contributors. Thus, the service provided by the Tribunal that is free of charge to complainants is certainly cheaper than the alternative of using the courts and has probably improved equity more generally among fund members.*

We agree with the above statement. The existence of the Tribunal has ensured equity between members in their ability to access an independent review of their complaint.

Further down it is stated that: -

> *"The statutory independence of the Tribunal, as compared to an industry-based scheme, could also be regarded as an advantage. Further, it could be argued that the existence of such a body helps to increase community confidence in superannuation and its processes".*

Given that superannuation constitutes a unique form of investment, in that contributions to superannuation are mandated by the SG legislation and superannuation comprises two of the three major planks of the government's Retirement Incomes Policy (the other being the Age Pension), a statutorily independent body is warranted.

Further down Page 135 it is stated that: -

> *"The Tribunal's reporting obligations, as set out in the Act, may represent an additional benefit by providing information for the regulator. This information is provided in the form of an annual report containing data on the number and nature of complaints and indicating the way in which they are handled. Such information may not be so easily accessible through the court system".*

An additional benefit is the publication of the determinations and the reasons for reaching the determination. This provides a valuable "feedback loop" to trustees in the industry with respect to various industry and fund practices and decisions which would not otherwise be available.

Under **"8.4 Costs"** at Page 135 it is stated that: -

> *"In addition to the administrative cost of the Tribunal, there is also the cost to funds and certain service providers of complying with the Tribunal's processes and the cost to members in making the complaint. Some have argued that there is minimal additional cost in complying with the Tribunal's requirements since a fund subject to a complaint would have already gone through its internal review processes".*

We would agree that there is minimal additional cost in complying with the Tribunal's requirements as the fund has already gone through its internal complaints handling mechanism.

Under **"8.5 Preliminary conclusion"** at Page 136 it is stated that: -

> *" While it is difficult to quantify the benefits and costs of the legislation, the Commission considers that, on the basis of the available information, the legislation which established this independent tribunal has clear advantages when compared with the alternative of reliance on the court system — in particular, in cost to the complainant.*
>
> *It is likely that any reversion to reliance on the courts would be strongly opposed by segments of the industry and consumer groups. Inquiry participants generally supported the continuing operation of the Tribunal as a statutory body".*

We agree with the preliminary conclusion.

Under **"8.6 Scope for improvement"** at Page 137 it is stated that: -

> *"The Commission considers there is scope to improve the benefits of external disputes resolution through better coordination with internal mechanisms for handling inquiries and complaints.*

We agree with this statement.

Under the heading **"Internal dispute arrangements"** at Page 137 it is stated that: -

> *"The SIS Regulations (part 2, 2.28) require trustees to give to each member of the fund details (in summary form) of arrangements that the fund has established to deal with inquiries or complaints. They do not indicate that the member must first use the internal dispute settlement arrangements before approaching the Tribunal".*

It should be noted that, despite the absence of regulatory prescription, a number of funds do advise members that they must first use the fund's internal dispute handling mechanism before approaching the Tribunal. Furthermore, during its establishment the Tribunal released some suggested wording with respect to its existence and function which is frequently adopted by funds and which refers to the requirement for members to have been through the fund's internal complaint resolution process.

Further down it is stated that: -

> *"Under the SIS Act, trustees are required to provide fund members with certain information about the existence and functions of the Tribunal. (These are also set out in Superannuation Circular No I.E.1.) However, the SIS Act disclosure requirements do not require the trustee to outline the types of complaints that fall outside the Tribunal's jurisdiction. It would be desirable that trustees be required to do so, in order to reduce costs incurred by the Tribunal in assessing the eligibility of complaints, as well as the cost to members in terms of misplaced effort".*

We agree with this statement and suggest that perhaps the Tribunal could provide some recommended wording for this purpose.

Accordingly, we agree with **DRAFT FINDING 8.1** to the effect that: -

> ***"There would be value in trustees providing members with information about the categories of complaints that are excluded from consideration by the Superannuation Complaints Tribunal".***

Under the heading **"Industry body"** on Page 138 it is stated that: -

> *"Some argue that an advantage of an industry-based scheme is that member entities then have a proprietary interest in abiding by its decisions. In the event of failure to abide by a decision, a fund would be subject to action by ASIC which could jeopardise its status as a complying fund for tax concession purposes. Further, such a body would provide a more direct and contestable method of financing than that which presently occurs through the Commonwealth budget by means of a levy. For example, in addition to fees paid by members, a direct charge is made on members by the Financial Industry Complaints Service (FICS) for handling complaints. This charge increases considerably for those complaints requiring more than negotiation and needing resolution by an adjudicator or panel. It could be argued that in this case the existence of such a visible fee imposes a strong discipline on industry members to try to resolve complaints internally or, at least, in the early stages of dealing with FICS".*

We would submit that, insofar as member entities having a proprietary interest in abiding by the decision of an industry body is concerned, this is not relevant in the context of comparison with the Tribunal. As it is an operating standard that a trustee must comply with a determination made by the Tribunal, it is irrelevant whether or not the member entity has a proprietary interest in abiding by the decision.

While the visible fee may impose a discipline on industry members to try to resolve complaints expeditiously, self - regulation could see considerable resources utilised in deliberating the appropriate basis upon which to levy such fees. In addition, funds with especially "litigious" members, for whatever reason, could be unduly penalised.

Further down it is stated that: -

> *"Decisions of an industry-based body could be subject to appeal to the courts by complainants. In contrast, appeals against the Tribunal's decisions can only be made on questions of law".*

If the objective is to facilitate appeals to the courts de novo, then members could be allowed to commence legal action if dissatisfied with the outcome of the Tribunal's determination. Of course, if under either system (Tribunal or industry body), recourse needs to be made to the legal system the outcome may prove costly, time-consuming and distressing.

Under the heading **"Other bodies",** on Page 142, it is stated: -

> *"In summary, these are not necessarily models that would be well suited to superannuation due to the smaller number of providers involved. However, together with the FICS, their existence indicates that a number of ASIC-approved disputes resolution bodies are operating in the financial sector".*

We would submit that these models would not be suited to superannuation due to the significantly larger number of superannuation funds involved. Further, the existence of multiple, sub-industry specific, dispute resolution bodies serves to indicated the need for specialised knowledge and experience in the product which is the subject of the complaint.

Under **"8.7 Assessment"** on Page 142 it is stated that: -

> *"For equity reasons, as well as efficiency reasons, any external disputes resolution body should be available to members of all regulated superannuation entities (except members of self managed superannuation funds where disputes, if any, are likely to be of a different nature because all members are trustees). Universal access by members of funds could be achieved most effectively by requiring funds to be members of an approved external disputes resolution body as part of the ongoing compliance requirements of APRA-regulated superannuation entities. The Commission does not see that there is a need to be prescriptive about suitable disputes resolution bodies for superannuation, other than for the funds to choose an appropriately licensed body. This is consistent with the provisions contained in the Financial Services Reform Bill that require funds to have an internal and external disputes resolution mechanism. Any appropriately licensed body chosen by a superannuation entity would be subject to a measure of commercial discipline as regards the efficiency of its operation".*

The tribunal is available to members of all regulated super entities other than exempt public sector schemes and self managed funds, and accordingly, we query the assessment that universal access could be achieved most effectively by requiring funds to be members of an appropriate licensed body. If funds are free to select which external dispute resolution body they will use this could result in "approved scheme" arbitrage and inconsistent outcomes for members.

On Page 143 it is stated that: -

> *"As outlined in the guidelines, decisions of an external disputes resolution body should be binding on the subscriber funds. Individual members of funds would still have access to the courts if dissatisfied with decisions of the external disputes resolution body chosen by the funds. This would counter any perception which could arise that the dispute resolution body chosen by the funds was unduly influenced by trustee or manager interests to the detriment of an individual member".*

It should be noted that Determination of the Tribunal is binding on the trustee of the superannuation fund.

It is difficult to see how a member having access to the courts "would counter any perception ... that the dispute resolution body ... was unduly influenced". Enabling an appeal from a decision making body does not of itself displace such a perception except to the extent that an individual member can afford to have a particular decision reviewed.

Further down the page it is stated that: -

> *"The Commission thus considers that the preferred arrangements for handling members' superannuation complaints should include the choice by trustees of funds of a licensed, independent, external disputes resolution body which could review complaints that are not able to be resolved by funds' internal disputes processes".*

We would submit that the Tribunal is preferable on the grounds that it is preferable that there be one body, to promote uniformity and consistency in approach..

The Tribunal has the added advantage that, as a statutory body, it is truly independent. As justice not only has to be done, but has to be seen to be done, given the mandatory nature of superannuation, and the importance of its role in achieving retirement incomes policy objectives, we consider the statutory independence of the Tribunal to be of paramount importance.

It is then stated that: -

> *"The provision of complaints resolution services would be a contestable activity so that more than one complaints resolution agency could establish and compete for business among trustees".*

We would consider the provision of a complaints resolution service not to be a "business" per se, but instead a critical component of prudential supervision.

Furthermore, given that the trustee would be the entity to select the complaints resolution agency, allowing agencies to compete for business could produce outcomes which were less favourable to the members of the superannuation funds. Placing reliance on the existence of a judicial appeals process to ensure objective decisions are made is not appropriate.

Accordingly, we do not agree with **DRAFT RECOMMENDATION 8.1** on Page 143 as follows:

> ***"The Superannuation (Resolution of Complaints) Act 1993 should be repealed, subject to some transitional arrangements.***
>
> ***All superannuation entities regulated by the Australian Prudential Regulation Authority should be required to join a disputes resolution scheme approved by the Australian Securities and Investments Commission. This should be mandated as part of the compliance requirements of those superannuation entities".***

Under **"Retain Tribunal with possible modifications"** under the heading **"Fee"** on Page 144, it is stated that: -

> *"Fee*
> *A high proportion of written complaints made to the Tribunal are outside its jurisdiction. In 1999-2000, 42 per cent of complaints that were outside the Tribunal's jurisdiction were excluded because the complainant had not first approached a fund's internal dispute process. This indicates there may be scope to introduce measures to reduce the number of such complaints, thus avoiding the need to divert Tribunal resources to deal with them. One way of achieving this could be to introduce a lodgement fee that could be refunded if the complaint is upheld. The advantage of this approach is that it would encourage complainants to prepare carefully before submitting a complaint and to reduce the Tribunal's costs, with eventual benefits for members of superannuation entities that are levied to finance it".*

While the introduction of a lodgement fee may be one measure to reduce the number of complaints which had not first been through the fund's internal dispute resolution process, there may be preferable alternatives to this.

One possible alternative may include measures such as requiring the member to lodge documentary evidence of having been through the fund's internal complaints handling mechanism prior to lodging the complaint with the Tribunal.

In the absence of such documentary evidence, the member could lodge a statutory declaration with their complaint to the effect that they have been through the fund's internal complaints handling mechanism. This could be accompanied by the name and contact telephone number of the fund's complaints officer, who could be 'phoned to verify whether the complaint has been through the fund's internal process.

It is stated on Page 145 that: -

> *"A feature of all external dispute resolution bodies is that they provide low-cost access to consumers".*

We consider it to be of paramount importance that access to an external dispute resolution body be, if not free, then extremely low cost. The introduction of a fee could prove onerous for low income individuals and may have the effect of deterring application.

Under the heading **"Extend statutory time limit"** on Page 145 appear **DRAFT RECOMMENDATION 8**.2 as follows: -

> ***"The Superannuation Complaints Tribunal should be given discretion to extend beyond one year the time limit for its decision on appeals against trustees' actions on disability payments".***

We agree with this recommendation.

Under the heading **"Naming certain funds"** on Page 146 it is suggested that: -

> *"Naming of funds could have the advantage of encouraging resolution of complaints at the internal stage, thereby avoiding some costs".*

This statement is predicated on an assumption that the responsibility for complaints not being resolved at the internal stage lies with the trustee of the fund, who would be "shamed" by being named.

In a number of instances it is the member who is responsible for perpetuating the complaint, either because of a perception of the need for an impartial, objective determination or because of the nature of the complaint.

With respect to complaints that a member is totally and permanently disabled, a member whose claims has been declined has an obvious interest in having the decision reviewed. The distribution of death benefits, by their very nature (especially given that they can be fairly subjective), are difficult to resolve to the satisfaction of all parties concerned.

On Page 146 it is stated that: -

> *"While the Commission considers that the Tribunal's comments on this issue have some validity, it generally supports the principle of transparency. For that reason, the Commission considers that superannuation entities that are the subject of complaints to the Tribunal that are handled by review should be named. At the same time it could be appropriate for the Tribunal to point out that many complaints are resolved satisfactorily by entities without any need for use of the Tribunal's processes".*

While we generally are supportive of the principles of transparency, we feel that any effort on the part of the Tribunal to point out that many complaints are resolved satisfactorily would be outweighed by the potential damage which could be done.

There is frequently a tendency to perceive that the very fact of there having been a complaint made implies that there is some underlying substance to the complaint, irrespective of the outcome. Given that the Tribunal has the ability to name recalcitrant trustee in its annual report to Parliament, we do not consider that any benefit in naming trustees would outweigh the potential cost.

Accordingly, we do not agree with **DRAFT RECOMMENDATION 8.3** as follows: -

> ***"The Superannuation Complaints Tribunal should publish the names of those superannuation entities that are the subject of complaints to the Tribunal that are determined by review or arbitration.***

Under the heading **"9 Other legislation under review"** under the heading **"9.1 Providing for financial assistance in some 'failure' situations**" under the further heading **"Assessment"** on Page 153 it is stated that: -

> *"The Commission considers that the existing provisions in the Levy Act and part 23 of the SIS Act for dealing with losses incurred by an APRA-regulated fund, as a result of fraud or theft, should continue. Providing financial assistance and financing that assistance by a levy on all eligible funds is justified on equity grounds of sharing losses which would otherwise be incurred by members of prudentially-regulated funds adversely affected by fraudulent conduct or theft. The arrangement is also likely to be cost-effective"*

We support the current legislation and note that the conditions precedent, that the loss results from fraudulent conduct or theft and causes a substantial diminution of the fund leading to difficulties in the payment of benefits, appear to ensure that financial assistance would be granted in appropriate circumstances.

On Page 154 it is stated: -

> *"Some flexibility in the application of a public interest criterion may be appropriate, given the difficulty of specifying in the legislation guidelines that will be applicable in all circumstances. However, this leaves the Minister with substantial discretion in awarding financial assistance.*
>
> *The Commission believes that the process of deciding whether to grant financial assistance in the event of fraud or theft should be more transparent. The SIS Act requires the Minister to seek advice from APRA when considering a request for financial assistance, and to table that request for advice in the Parliament. It does not require APRA's advice, or the reasons for the Minister's decision, to be tabled.*

Therefore, the Commission recommends amendment of part 23 of SIS to require the tabling of APRA's advice and the reasons for the Minister's decision".

While we support the principle of transparency we would submit that, on balance, requiring APRA's advice, and the reasons for the Minister's decision, to be tabled in Parliament could have a number of consequences. It could result in significant adverse publicity for the affected fund, damage public confidence in superannuation, provide information as to how the fraud or theft was perpetuated, unnecessarily restrict the disclosure of information, ad the giving of advice, by APRA to the Minister and generally impede the decision – making process.

For these reasons, we do not agree with **DRAFT RECOMMENDATION 9.1** as follows: -

"Part 23 of the Superannuation Industry (Supervision) Act 1993 should be amended to require the Minister to table in Parliament, as soon as practicable, the Australian Prudential Regulation Authority's advice and the reasons for the Minister's decision on whether to provide financial assistance to funds which suffer significant loss from theft or fraud.

Under the heading **"9.2 Funding supervision of self-managed superannuation funds"** under the further heading **"Alternative"** at Page 157 it is stated that: -

"The only practical alternative to the present means of recovering the costs of regulating SMSFs would be to use budget funding. Given that the prudential supervision of superannuation instils public confidence in the system and more generally has benefits for the wider community, there may be a case to use consolidated revenue for prudential regulation.

However, the costs of this regulatory task for SMSFs can be readily identified and separated from the costs associated with supervision of other types of funds. Moreover, the members of SMSFs benefit directly from supervision by the ATO. SMSFs also have different risk characteristics and pose different regulatory issues than other superannuation entities. It is appropriate that their supervision be paid for by their members".

We would submit that, given their nature, SMSFs do not warrant, nor do they receive, prudential supervision. As stated on Page 156 "The supervision is required to provide added assurance that SMSFs are established and operated in accordance with the **retirement income and revenue protection provisions** of the SIS legislation" (emphasis added).

SMSFs are not the type of superannuation entities whose prudential supervision instils public confidence in the system and whose failure damages such confidence. It is superannuation funds other than SMSFs which warrant prudential supervision for these reasons.

Accordingly, there is little case to use budget funding for SMSFs, especially when you have regard to the fact that the prudential supervision of non SMSFs is not funded from consolidated revenue but that instead these funds pay considerably more in the way of supervisory levy.

Under the heading **"Assessment"** at Page 157 it is stated that: -

> *"The Commission considers that the principle of recovery of the costs of regulatory supervision within the financial sector is sound and that it is appropriate to impose a levy on SMSFs which recovers the associated costs. In this manner, pressure is maintained within the sector to seek an appropriate level of regulatory supervision and for it to be provided in a cost-effective manner".*

We agree with the above statement.

Accordingly, we agree with DRAFT FINDING 9.1 on Page 158 as follows: -

> ***"Given the more limited nature of the regulatory supervision of self-managed superannuation funds, it is appropriate that their supervision be funded separately from that of other superannuation entities and be based on full recovery of the costs incurred by the ATO in providing that supervision. It is important that the ATO publish the cost components involved in its regulatory supervision of self-managed superannuation funds, to ensure accountability".***

Under the heading **"9.3 Occupational Superannuation Standards Regulations Application Act"** under the further heading **"Assessment"** on Page 159 it is stated that: -

> *"The OSSRA Act no longer serves any purpose. The conditions which gave rise to the need for the Act no longer exert any influence over the management and supervision of superannuation funds and it accords no benefits to fund members. Also, it can potentially cause confusion with remnants of the Occupational Superannuation Standards Act which remain necessary to protect the interests of some fund members. As the ATO said:*
> *The Act is now of little relevance (since the Occupational Superannuation Standards Act and Regulations were repealed on the introduction of the SIS Act and Regulations). sub. 28, p. 1)*
>
> *The OSSRA Act should be repealed".*

We agree with the above statement.

Accordingly, we concur with DRAFT RECOMMENDATION 9.2 as follows: -

> ***"The Occupational Superannuation Standards Regulations Application Act 1992 should be repealed".***

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