

## INDUSTRY FUNDS FORUM

### FINANCIAL SECTOR REGULATION-FEEDBACK FORM

#### 1. Challenges and impact of financial sector regulation

The financial sector regulation presenting the greatest challenges for the superannuation industry is:

- the volume of consumer disclosure and prescribed information, which tends to be counterproductive to consumer comprehension and comparability;
- the administrative complexity of implementing legislative change, particularly in light of the high level of government interest in the superannuation system;
- the overlapping regulatory responsibilities of APRA and ASIC, with residual responsibilities of the ATO; and
- the overlapping and inconsistent breach reporting regimes of APRA and ASIC.

The impact on the efficiency of the superannuation sector is:

- undue emphasis on form, rather than substance, with the tendency of obscuring the simple market message of retirement planning;
- an overly negative approach to communicating to the market;
- a disproportionate concentration of resources on regulatory reporting and internal control and review; and
- uncertainty and unease in operating within the regulatory requirements. (More detail is provided in response to Question 4)

Regulation is essential for protection of members' funds, proper disclosure and appropriate market conduct. However, regulation should not impede effective communication and efficient service for members. Government and regulators should view the superannuation industry in the sense of a partnership, working together with a common interest of retirement planning for all Australians.

#### 2. Compliance burden

It is difficult to measure the proportion of administrative processes and resources devoted to compliance activities in consequence of regulation. In practical terms, regulation has been responsible for the growth of ancillary or service staff in the superannuation industry. In particular, the industry has seen the establishment of in-house legal and compliance services and risk management functions (formerly performed by the Fund Secretary, comparable to a company secretary).

Regulation has also been responsible for the growth of in house marketing teams in proportion to the increasing complexity of public disclosure and information.

In organisational resources, an increasing time is spent in considering and debating regulatory compliance issues as well as obtaining external legal advice and sign-offs.

The increase in disclosure responsibility has seen greater resort to external legal advice to provide comfort. In particular, the requirement to report significant breaches to ASIC has resulted in the widespread use of external law firms to justify a decision whether or not to report.

The rising cost of compliance may be seen in the immoderate increases in the APRA industry supervisory levy imposed on major superannuation funds.

### 3. Regulatory requirements

- a. **Overlap:** There is an overlap between APRA and ASIC. While ASIC's charter is consumer protection and corporate regulation with APRA regulating prudential management and risk control, the distinction does not work in practice. Consumer protection overlaps with prudential management and risk control. Consumer protection not only involves protection at point of sale (consumers making an informed decision to invest) but also extends to ensuring the safety of the consumer's investment. The safety of an investment in turns depends on the integrity of the risk controls (APRA) and the effectiveness of corporate governance (ASIC). Likewise, the system of corporate regulation protects not only consumers but buttresses the integrity of the national financial system. The failure of corporate regulation threatens the stability of the Australian economy.

More recently, the distinction between ASIC and APRA functions has become more blurred with the Financial Services licensing regime extending to superannuation funds, rather than exempting superannuation funds to remain under full APRA supervision.

On a daily administrative level, superannuation funds have an ASIC licence and an APRA licence, while being required to display (at differing levels) an ABN number, an ASIC licence number, an APRA trustee number and an APRA fund number. Funds file various statutory returns with both regulators and are liable to on site audits by both.

The practical overlap is exemplified by each regulator having a system for notifying the other of notified contraventions. Another example is the APRA licence which requires a fit and proper test for appointment and continuation of fund directors, which reflects a key principle of corporate conduct and regulation.

We consider it is timely to re-visit the 1996 recommendations of the Wallis Inquiry, which urged the creation of a separate prudential regulator. The above experience has shown that prudential supervision cannot be segregated from corporate regulation.

- b. **Inconsistencies:** The major inconsistency is breach reporting requirements between ASIC and APRA. In the case of ASIC, funds must report a breach within 5 days of becoming aware of its significance. In the case of APRA, funds must notify all breaches (irrespective of significance) within 14 days of becoming aware. A material breach of a provision in the superannuation legislation is at once a breach reportable to ASIC and a breach separately reportable to APRA. Notwithstanding this dual reporting system, both regulators have arrangements to inform the other of notified breaches.

It is difficult to see any justification in the public interest for reporting all breaches, irrespective of significance, to a Regulator. The administrative burden of reporting as well as receiving and assessing each breach report must take a significant toll.

- c. **Out of date regulation:** Regulations that are out of date by industry trends are the restrictions on emailing consumer documents and the various state evidence laws on the admissibility of electronically or machine produced documents (both of which were addressed in the previous questionnaire on financial services regulation and technology).

- d. **Regulation hindering the introduction of new products:** We are not aware of any regulation that hinders the introduction of new products.

#### 4. Improvements to regulatory operation

We recommend:

- the two regulators, ASIC and APRA be merged;
- a single breach reporting regime with a materiality threshold;
- a uniform wording and content for Product Disclosure Statements;
- a more positive approach by ASIC in giving industry guidance; in particular the issue of giving general advice; and
- ATO having a closer engagement with the superannuation industry.

The first two recommendations are explained in section 3 above. The remaining recommendations are explained as follows.

##### Uniform PDS

A uniform PDS would ensure clear communication for consumers to enable informed decision making and comparability. At present, the product disclosure regime is subject to two major flaws:

- the underlying complexity of the superannuation system, reflected in the detailed content requirements for a PDS, results in documents of over 60 pages; and
- despite the content requirements, the language, treatment and emphasis in the PDS is self-produced by the product issuer.

At present, the content requirements for a PDS are extremely wide and generalised. For instance, the information requirements include:

- “significant risks associated with holding the product”;
- “significant characteristics or features of the product”; and
- “any significant taxation implications’ of the product.

As a result, there are significant variations in PDS descriptions of investment risk, taxation issues and features of superannuation. The task of writing information to meet these requirements is riddled with uncertainty.

We consider the industry needs a prescribed PDS wording. Prescribed wording for consumer information is nothing new and already applies to the fee template. The government’s proposal for a short form PDS with details of access to a long form PDS is noted. However, this is a short-term solution. A prescribed PDS format is required to ensure certainty for the issuer, to assist comparability for the consumer and to exclude gratuitous marketing accretions.

Needless to say, the prescribed wording would allow fund-specific information with its description of its structure, objectives and services.

##### Industry guidance

We sense a degree of unease and lack of confidence in the industry in seeking to comply with the ASIC requirements of general advice while not trespassing on the boundaries of personal advice. We find that ASIC guidance on the matter is unduly cautious and guarded. Guidance should acknowledge, for the benefit of the industry,

that a consumer question has an inevitable personal element and that the general advice regulation fastens on the answer given by the licensee.

In other words, the licensee must ensure that any advice *given by the licensee* must not take account of the enquirer's objectives, financial situation or needs. This way, the industry can focus on the advice given, rather than being placed in a dilemma (especially in the context of a call centre) whether to reject the question or attempt an answer.

Similarly, the climate of negativity and ambiguity in the arena of general advice has seen many funds abandoning the use of online calculators. The guidance on this matter could have been more positive and been expressed more clearly and forthrightly. ASIC's repeated but generalised warnings against giving personal advice, without more, are unhelpful. Calculators are a valuable education tool and this development represents a loss for consumers.

However, we commend ASIC for the accessibility of its staff in industry forums and seminars. Consistent with this, we would greatly appreciate a corresponding frankness in ASIC's guidance information.

### **Engagement of ATO**

While the ATO is universally associated with revenue collection, the ATO serves a residual regulatory function in the industry through its administration of non-revenue areas, such as superannuation guarantee, government co-contributions and choice of fund. As in the case of ASIC and APRA, the industry needs to engage in close dialogue and consultation with the ATO. We recommend the ATO create robust systems for industry advice and consultation. At present, many funds experience frustration in communicating with the ATO in these non-revenue areas.

### **5. Feedback from stakeholders**

We have experienced some disappointment, particularly in call centres, expressed by consumers when told of advice restrictions. In this situation, the consumer thinks a simple answer should be provided when they have no interest in seeking advice from a financial planner.

Consumer testing by superannuation funds of individuals' understanding of superannuation issues did not reveal any improvement in consumer literacy in the light of the new disclosure requirements<sup>1</sup>.

Participating employers have referred to the administrative burden of recent legislative change, eg. choice of fund, although having a sense of inevitability of these changes.

### **6. Experiences in dealing with regulators and Treasury**

Generally, our experience has been positive. The Treasury website is informative and regulators participate in industry forums and consultations. We recommend that Treasury acknowledge receipt of submissions and respond, where appropriate, to substantive points expressed in submissions. Providing a response to a major submission has the advantage of resolving an issue. A response can be published generally, rather than answered individually.

An example is the fee disclosure regulations where earlier feedback from Treasury would have obviated the subsequent changes to the Regulations. We consider that

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<sup>1</sup> Roberts Research Group, Members' Education research for Education Key, August 2005

Treasury should have provided a cogent response to industry's submissions for projections of fees over the life of the product.

Delay in finalising Regulations should be explained to the industry. For instance, the Interdependency Regulations were released in May 2005 with submissions closing in June. Nothing further has been heard, although the Regulations will operate retrospectively.

Similarly, Regulations should be released in sufficient time to allow industry to implement the changes. The July 2004 package of changes (involving early release, contributions acceptance and related matters) was released only 1 week prior to its 1 July 2004 commencement. While Treasury announced the package in general terms in the previous February, it is not to the point that the industry had been on notice for some 5 months, when the detail was not available.

We recommend that regulators' response to industry concerns should take into account practical implementation issues. We consider that ASIC's response to the length of the new PDS documents released by the industry (by criticising lawyers) lacked awareness of the complexity of the regulatory requirements confronting the industry. In our opinion, the better response was to acknowledge the difficulty in striking a balance between full disclosure and concise communication and to explain that Parliament had imposed detailed prescriptions for the protection of the consumer. It should be self-evident that the preparation of a PDS starts with a checklist created in response to each regulatory prescription.

## **7. Additional comments re superannuation sector regulation**

We acknowledge the high level of political interest in the superannuation industry and retirement planning. The regulation of the superannuation industry is interlinked with government revenue and social security policy along with broad social policies of retirement planning, prudential supervision and consumer protection.

The present regulatory landscape for the superannuation industry is one of great complexity with intense political scrutiny and almost unrelenting regulatory change. The major cause of the complexity is the taxation system. The purpose of the regulations governing cashing and contribution rules, together with RBL's, ETP's, work tests and deduction rules is to prevent abuse of the concessional tax rates. The simplification of the tax system by adopting the overseas model of taxing at point of exit (in place of the current 3 stage system of taxing inflows, earnings and outflows) would eliminate the elaborate regulatory superstructure currently encumbering the superannuation industry.