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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

INQUIRY INTO SUPERANNUATION

MR J.H. COSGROVE, Commissioner
MR R. FRENEY, Associate Commissioner

TRANSCRIPT OF PROCEEDINGS

AT MELBOURNE ON TUESDAY, 15 MAY 2001, AT 10.01 AM

Continued from 10/5/01 in Sydney

MR COSGROVE: Good morning, everybody. We are now resuming the initial set of hearings on the productivity commission's review of the Superannuation Industry (Supervision) Act 1993 and certain other superannuation legislation. As people can see from our nameplates, my name is John Cosgrove. I'm the presiding commissioner on this inquiry. With me is Roger Freney who is an associate commissioner for the duration of the inquiry. At the beginning of these hearings in Sydney last week I made some extensive remarks about the nature of the inquiry and the way in which the hearings are conducted. I don't propose here to repeat those remarks but anybody interested in reading them will be able to find them on our Web site or through obtaining a physical copy of the transcript of the Sydney hearings.

It is perhaps worth saying that the purpose of the hearings is to provide interested parties with the opportunity to put their submissions and views on the public record. This will not only help us in our task of assessing the costs and benefits of legislation which has been referred to us but also will assist us in reviewing possible alternative means of achieving the objectives of those various acts. These hearings are conducted as informally as we can but participants are required to provide accurate information and to refrain from misleading the commission as I'm sure you all will.

The process from here on in, as people probably generally know, is that we will be releasing a draft report in due course, we hope around about the end of July, and that will be a public document available for people's consideration. It will be followed by a further round of public hearings which will enable people again to give us their reactions to that draft report and we will be taking those views into account of course in our finalisation of the report which is due to be delivered to the government in early November.

We can still receive submissions from people who have not yet given them to us but the earlier they come to us the more likely it is that we will be able to give them proper and full consideration in our preparation of the draft report. Beyond that I think it's simply a question of asking each of the participants who are appearing before us today to identify themselves and indicate the capacity in which they are appearing. Our first participant this morning is the Corporate Super Association I think. Would you each identify yourselves please, gentlemen.

MR CERCHE: Yes, gentlemen. My name is Mark Cerche and I'm the chairman of the association.

MR BROOKES: My name is Nicholas Brookes. I'm the chief executive of the Corporate Super Association.

MR COSGROVE: Thank you both, and thank you for the submission which you have provided to us which we have had a chance to read. Are there particular elements of it that you wish to draw to our attention or would you simply like to discuss it? We're in your hands to some extent.

MR CERCHE: If I may, I would like to address the commission on the underlying basis upon which we consider SIS rests and why the principles of it, whether in SIS or in some other legal form, are considered by us to be desirable. As you can tell, chairman, from my hair, I have been around this industry for a little while and was involved in the drawing up of the SIS Act and its regulations which was based of course on the Occupational Superannuation Standards Legislation which preceded it. The reason why it came into existence was the Commonwealth constitutional power. We have seen how, in Corporations Law, the Commonwealth has struggled to pass law which has been able to consider to be sound. Well, the Superannuation Industry (Supervision) Act arose because the Commonwealth lacked the constitutional power to legislate directly and we shouldn't forget that in this exercise. It wasn't something that was raised in the submission but it's something which I think is necessary for us to remember.

The legislation was designed to do two things. The first was to set up a minimal set of prudential rules which justified superannuation products being granted tax concessions. If you met these rules you were tax conceded. If you didn't you were punished and you were no longer entitled to benefits of the lower tax regime. If you like, they were the prudential rules which underpinned an ebbing and flowing incomes retirement policy in this country. One could quibble with them but essentially one understood that the government's view was that superannuation funds shouldn't borrow and shouldn't charge their assets and those sorts of things, and if that's what the rules are then that's what the rules are. You either meet them and get the taxation concessions or you don't. So there was a voluntary nature of it to start with.

The second element of the legislation was it recognised two basic ways of delivering this product into Australia. The first one was the traditional way of delivering superannuation through voluntary trustees. The voluntary trustee system in Australia had been in existence since I think the 1920s and had more or less flourished over that time until 1987 when the Occupational Superannuation Standards Legislation was introduced and ultimately the SIS legislation was introduced and the legislation admitted a regulatory framework which allowed the mutual, not-for-profit superannuation to continue to be regulated by self-regulations essentially, the principle being that the members took an active interest and voted for the representatives and the trustee was prohibited from making a profit from its role then one would expect the law to be observed, for people to carry out their duties properly, and to carry out their functions as trustee in a proper and appropriate way. The evidence seems overwhelmingly to support that conclusion.

Not to my knowledge has there been a major failure of a superannuation fund which has complied with the rules. There have been failures of funds which have not complied with the rules but we have seen that in other areas as well. If people aren't prepared to comply with the rules and are prepared to risk the penalties which the law extracts then there will be failures, either through criminal behaviour or other behaviour, but so far as I'm aware the superannuation not-for-profit sector in this country has by and large delivered against the expectations of the membership and the regulators.

The other possibility which was reflected in the Superannuation Industry (Supervision) Act which overlapped to some extent with the Corporations Law was the possibility of there being a public offer fund which was run by an organisation which did not have to meet the basic equal representation rules. We tend to forget history when we come to look at laws. The basic rule was unless you met the criteria, the traditional criteria, you had to be licensed and you couldn't offer these products and you had to offer them in a particular way. It's funny how the world turns but the legislation was structured in that way and it was structured to support and enhance what was at that time the primary method of delivering superannuation into this country.

The full profit sector has embraced superannuation as an industry to be involved in and they have done so quite properly to make profits for their shareholders but they have no other reason to be in the industry, and certainly if there is no profit for their shareholders they will exit this industry as they should. Their job is to make profit for shareholders, and coincidentally to manage and comply with the law but we must accept that their legitimate aim in participating in this industry is certainly to comply with the laws because they're required to but to generate as much profit out of it as they possibly can and they will be failing in their duties if they didn't do that.

So the tension which the superannuation industry legislation attempted to address was the tension between the traditional way of delivering superannuation and allowing competition in this type of enterprise in a regime which was outside the Corporations Law, because it couldn't be in the Corporations Law, to enable full profit organisations to effectively compete. It was to compete in an area where we weren't talking about discretionary savings. Rather, we were talking about employers' contractual obligations and in the end statutory obligations; statutory obligation in the sense to avoid a tax, one made a contribution to a superannuation fund, but largely this industry was concerned with the employer complying with an obligation imposed upon it or assumed by it and that's what the industry was about. It still is about that. There's very little voluntary savings in the superannuation industry as we know it. Certainly in the do-it-yourself area there's a huge amount of "voluntary" savings, and presumably bona fide for retirement, but the growth in this industry in that sense is in the individually controlled funds where wealthy people by and large are taking advantage of the rules to save for their retirement and to also shelter their assets in a tax benefited environment. Good luck to them. I wish I was wealthy enough to be able to do it.

Reverting now to my constituency which is the corporate superannuation industry, our industry has continued under the Superannuation Industry (Supervision)

Act and has had no difficulty complying with it. There has not been rules in there that are - there are some silly rules in there, of course, because some of the rules are designed to stop individuals investing back in their own privately held companies. That really is not an interest to us per se and the in-house asset rules affect us only by accident when we find that our fund managers are overweight in us and suddenly we look at ourselves and we find that our superannuation fund, through no conscious act of us, has breached a law because fund managers have decided to up the weighting in News for example or some other company which is sponsoring a fund which has itself no direct interest in the underlying company, but apart from those little errors if you like the rules do not affect us.

Some of the rules do exclude us from investing in infrastructure-type products directly and we need to set up elaborate structures to comply with the law but by and large those are mere inconveniences and properly engineered. We can more or less invest in whatever we think is a proven investment, and adopting the modern portfolio theory, the current view is that there is a place in a portfolio of a $5 billion fund for some infrastructure investments provided we don't breach the law. So by and large we have managed to comply with the law without very little difficulty and very little inconvenience.

The benefit that we have been able to deliver to our members as opposed to our competitors is on the cost side of the equation. Typically we use investment managers and pay their fee or that part of the fee we have been unable to negotiate down, but we use investment managers typically for investments and securities and usually in property. We're typically now indirectly invested in property. Direct property investment is too hard for superannuation funds directly because of the borrowing restrictions and the need for - most supermarkets and similar developments are usually highly geared with the superannuation fund putting in mezzanine debt or mezzanine equity of some sort but through interposed entities but by and large we go through managers. Those investments that we hold directly - and it's typically a small part of our portfolio - are managed by corporate advisers and the infrastructure projects or the offshore investments which we sometimes look to investing to diversify the risk and to try and achieve returns where other markets are failing and it's a diversification issue for us. But the SIS legislation in that respect has had no difficulty for us.

Where we've been successful though is managing costs and typically our evidence is that our minor corporate funds are able to deliver to the members a product at a cost significantly lower than our competitors and in our submission we had a median major fund which we'd put at, in our own terms, $320 million assets under management. We've had a management expense ratio of less than half the master trust competitor. The bulk of our members of course are considerably in excess of the median that we've put in evidence and their management expense ratio is considerably lower than the .7 that we've put and the major funds in this country on the corporate side of things have a very competitive cost structure and of course the equation in the end, whether it be defined benefit or defined contribution is income less expense.

We've felt that we've delivered to our members, through the model that we've enjoyed, a superior investment return without prejudicing the security of the product which is being offered. I talk in terms of the product and it offends me slightly; we are not offering products, we are acting as trustees pure and simple and we're not in there for the money. We're in there for the mutual benefit that this arrangement brings both to the employer and to the member on the one hand. The thing I would impress on the commission is if change is necessary - and change is necessary - at least acknowledge the contribution and substance of the industry that's been fiddled with here.

We control - refresh my memory - $80 billion as in the corporate superannuation industry. My association represents $53 billion of that. That's twice the industry funds and half the rest, so we're a large slice of the Australian superannuation industry at the moment. To my mind we've delivered since 1920 products which have been accepted by our membership, appreciated by our membership and despite all the surveys that we've conducted amongst our membership, still appreciated by the membership. Our superannuation model in Australia has been studied and replicated in other places around the world too, so the not-for-profit sector has had its appeal in other places as well as Australia. That's all I think I need to say. The recommendations and the detailed submissions are before you. I don't intend to repeat them.

MR COSGROVE: Okay, thank you, Mark. You make quite an important distinction early on in your submission to us about the differences between the not-for-profit funds and the for-profit funds and you've presented information to us, as you were just saying, about the better costs performance of the corporate fund sector. Leaving that cost angle to one side for the moment, what would you say are the key differences. I mean, I understand you've got a board of trustees in a corporate fund, equal representation of employer and employees. A for-profit fund though also has a trust arrangement embodied in it. It might not have an equal representation aspect to it. What is it that you think is so important about the distinction, as I say, leaving the costs angle to one side.

MR CERCHE: It's hard to move away from the costs. The primary function of a corporate trustee - a corporation trustee - which is in the business of making money for a shareholder is to make money for its shareholders. It's an incidental function that it administers a superannuation fund. It makes a profit for its shareholders by keeping its costs below the amount it charges the fund. There's nothing hard about this but the - - -

MR COSGROVE: That's all out in the open and people can, on the basis of that knowledge, make a choice as to whether they wish to operate within a corporate fund or in some sort of retail fund.

MR CERCHE: That's the second aspect of the difference. We are delivering an employer promise to an employee. A typical publicly offered fund is receiving investments, discretionary investments, from a third party who has no association with that organisation apart from an expectation that its investment performance will deliver - taking account of its costs - an appropriate and satisfactory financial return. That's the competitive nature of the business. But our arrangements are typically above that in the sense that we are receiving an employer promise which is part of the employment contract to contribute, in the case of a defined benefit fund, whatever it costs, and typically in the case of a defined contribution fund, 11, 12 per cent I think is the average that we contribute - we employers contribute to our controlled fund.

In the case of public offer funds they typically receive either the SGC component from the employer or in some cases a further amount or in the very odd case a bit of the employee's after-tax dollars. There are of course people who - and because of the nature of the contributions that can be accepted into superannuation arrangements there has to be an employee component to it. A person has to be employed before they can sort of make contributions in this environment on a tax conceded basis.

MR BROOKES: If I could put in another point here. There's still competition adding on to the costs of the strategic advantages. On the one hand under the not-for-profit arrangement we have a board of people who are able to distance themselves from any self-interest financially in the underlying instruments and that itself leads to the best use, ultimate use of the free forces of competition, if I may explain that. They're able to look at areas of administration or investment management or custody - the key areas of operations for any superannuation fund - to use professional services to define which are the appropriate potential service providers, ask for requests for tenders, analyse those requests for tenders, request presentations, exercise proper due diligence independently of those service providers to then appoint one. That's stage 1. That will go across the whole range of services, so you may well have 10 or 12 investment managers, one admin provider perhaps and obviously tax accounting, legal et cetera or independent selection.

Secondly, having independently selected those particular advisers, those advisers are subject to the free forces of competition thereafter. The key point is that they are always subject to of course competition price and quality, not just price, so the trustees are able therefore to retain proper due diligence control, prudential control for the benefit of the underlying members of the fund to select and act appropriately in the best interests of their members. That's one position which is where we're coming from. The second position which is an alternative where you have a single responsible entity provider, say, for profit, a commercially driven service provider is completely the reverse which is that most of the services are provided in-house.

If the self-appointed trustee who is not independent is able to select, their one selection is their in-house services. They're not going to fire themselves now, are they?

MR COSGROVE: No, but they are still operating in a competitive environment.

MR BROOKES: In what respect?

MR COSGROVE: Well, let's just assume that a particular retail fund uses entirely in-house services of the kind you were just referring to and its performance is poor, now, it won't take too long, one would think, for that particular retail fund to start losing market share because there are other retail funds who can step in and offer better returns.

MR BROOKES: What you say makes absolute sense from a theoretical point of view but there are two drawbacks to that. When all the services are bundled into one service provider, administration, say, and investments, it's a dilemma actually. The dilemma is that that poor performance may be balanced by extremely good servicing and brilliant administration.

MR COSGROVE: Well, I mean, obviously the consumer - in this case the contributors - still know what's going on.

MR BROOKES: But they haven't got a choice.

MR COSGROVE: They may decide that the poorer returns are adequately offset by these other service aspects.

MR BROOKES: That's the point because you're absolutely right. It's a compromise, isn't it, whereas they don't need to compromise. You see in the current situation they take the best admin provider, they take the best investment forms, there's no need to have to accept a compromise - point number 1, I agree with you on that. The second point is to do with ongoing costs as having bundled the costs together and you've got average performance, pretty good administration. What happens to the prices eked up from X to X plus 10 per cent or X plus whatever percent? The response will be, that will be subject to competition correctly, but in actual practice it's not because it's actually now become - a transaction cost point it has now become - a sole supplier is governing the whole relationship of the client and the client has got a problem. Just suppose they don't like the increase in costs, what do they do? They have got to go through enormous costs in unscrambling the current arrangement, revisiting the whole decision-making apparatus, calling in outside independent advice, "Which master trust do I go and to when, which one do I select, how do we implement it and what do we do with the transfer from one fund to another, if at all?" Enormous costs. Probably again a compromise might come in. We said, "Reluctantly, we'll accept increase." Whereas in the current position, again no such compromise and disadvantage to members is required.

MR COSGROVE: Yes, I'm not quite sure the distinction is as sharp as you're drawing, Nicholas, but of course from our point of view the key question is not so much whether one particular type of superannuation fund is more satisfactory, more independent from the point of view of its members than another, but whether the legislation, in particular the SIS Act, in any way discriminates unfairly or uncompetitively between funds. Now, Mark, in your opening remarks, when you were talking about the historical evolution of the legislation, you seemed to suggest that SIS had within it now a degree of tension in terms of accommodating the for profit fund sector in a situation where it was originally designed for a predominantly corporate type of fund structure. Could you indicate whether you think there are any anti-competitive elements there?

MR CERCHE: Well, the tension is that the for profit bodies are not restricted by the employment relationship. The basic equal representation rules, and the superannuation product that's offered by a corporate fund, or a non-licensed fund, there has to be an employer sponsor. So for example if an employee ceases to be an employee, under the rules the fund can accept contribution from that employee for a period of two years, but then must cease, and it's a breach of the rules to do otherwise. So we're seeing now some not-for-profit funds seeking to become approved trustees so that they can receive contributions to retain benefit accounts from former employees who have gone to another position but want to have their contributions paid into this fund or want to make contributions to this fund, or employers are reluctant, if you like, to become employer sponsors of a particular fund but these funds are trying to maintain market share and grow by becoming approved trustees. I think that's the tension which is now starting to emerge.

The difficulty that the employer-sponsored arrangement has in becoming licensed is the rules that APRA impose on approved trustees, particularly the custodial arrangements, for example - and I notice today APRA is still of this view - that it is appropriate for an approved trustee to have a net asset value of $5 million. I noticed with some wry amusement that APRA thinks the general insurers should increase their capital adequacy from 2 to 5 million over five years to cover what appears to be a $3 billion deficiency, but that's just an irony that seems to have developed recently.

In the sorts of money that we're talking about, a $5 million capital adequacy is just a nonsense really. Most of our funds are over $100 million, but for a not-for-profit organisation to stump up $5 million means that it has to come from somewhere. It typically comes from a bank guarantee and that just adds to the cost of doing business, with no real additional protection for members at all. But that's the tension I've referred to, I think.

MR FRENEY: Can I ask, John: gentlemen, if you could just describe to me so I understand it clearly what the typical structure is in a major corporate employer-sponsored plan. Is it that you have a corporate entity?

MR CERCHE: Yes. Typically you have a corporation as the trustee because in - - -

MR FRENEY: You have a corporation, and that corporation is responsible for the running of a trust, which is of course as a trust deed and trustees.

MR CERCHE: Correct - no, the basic - of course, yes. I shouldn't say no ever. The basic structure - and now we're going back to the legal requirements, the Superannuation Industry (Supervision) Act - unless you pay old age pensions you have to have a corporate trustee, and the corporate trustee can, if it's an approved fund, not meet the basic equal representation rules, but if it's a pure corporate arrangement it has to meet the basic equal representation rules, and that means that half the trustee board must be representatives of the member either elected or appointed by a body that represents the members and the other half is appointed by the employer, which more or less mirrored what was happening in any event out in the industry before SIS came along. So there's no great hardship in any of this and the rationale was that the members are there to make sure that their fund is looked after; the employer is there to make sure that the employer's interest is looked after, because we tend also to forget that most of these large corporate funds provide defined benefits where the cost falls to the employer. So the employer had a legitimate interest in ensuring that the fund was properly run because if it wasn't it cost it.

MR FRENEY: I don't want to take too much time on this because, as John said, our main focus is on the SIS and what if anything should be done about the SIS, but in a sense under a licensing regime, which was something you pointed to as a concern in your submission, I'm just trying to understand whether there's not already an existing structure there for licenses to be issued, that is, the corporate trustee entity. I don't really understand what the concern is to your members.

MR CERCHE: The concern with licensing is (a) some other body determines who sits on the trustee board as opposed to the members and the employer. There's either an educational test, which is appropriate, but the most important thing about this is rather the capital adequacy rules.

MR FRENEY: Yes. I don't see it necessarily taking away the equal representative provisions.

MR CERCHE: It doesn't necessarily happen.

MR FRENEY: I haven't seen anything to that effect but I was wondering actually whether it might turn on this question of capital and whether it's a question of the corporate entity having to provide say operating capital or NTA or whatever sort of measures the regulator might deem appropriate.

MR CERCHE: There are two aspects to it. You can't really license somebody who you don't control. I mean, the idea of licensing somebody - traditionally if you have a car licence you've passed a driver's licence test; if you hold a gun licence you hold something else. If you're licensed to offer securities to the public you meet certain educational criteria. If you're licensed under the gaming industry you're not Mr Packer. So there are all these sorts of licensing, so when you license somebody who's elected it's a bit of a nonsense, because you don't control them at all or shouldn't, because somebody is elected and suddenly you withhold the licence because they don't meet some nebulous criteria that you have in the back of your mind about licensing.

APRA does have rules about educational qualifications in their licensing requirements for approved trustees, which are quite low actually, and I don't think there's ever been a problem in meeting those. But it's really the capital, and the $5 million capital adequacy requirement is waived if all the assets of the fund are put with the custodian who has $5 million. That leads to the inconvenience of a trustee being unable to pay benefits and being unable to write cheques and silly things like that, whereas that entity is responsible for everything. It just seems to me for the want of $5 million - - -

MR FRENEY: You might even say it's a weakness of SIS that there is not some kind of financial adequacy requirement on the trustee structure or the corporate structure above the trust, because equal representation is a very strong foundation plank, sure, but not to have some kind of requirement that the trust structure has the wherewithal to protect the interests of the members could be said to be a weakness perhaps.

MR CERCHE: I hear that. Typically the trustees are insured for negligence and fraud, computer fraud and all that sort of thing. A prudent trustee carries that sort of insurance. But $5 million doesn't go very far, does it, and to have a meaningful capital adequacy there would be very few players indeed in the area. But the short answer is if you require a typical corporate fund to have a $5 million capital adequacy they will be out of business, because they will have to go to the bank and get a bank guarantee, then they will have to arrange somehow for the same amount of money as the bank guarantee to be deposited with the bank so the bank has no risk, and pay a fee for the privilege. That just adds to the cost unnecessarily. It doesn't achieve anything really.

MR FRENEY: I suppose historically it's the employer that has provided the operating framework for the employer-sponsored trust - - -

MR CERCHE: Yes, and they still do.

MR FRENEY: They still do. I'm simply teasing out the issues here, I'm not advocating any particular structure, but that seems to me to be an interesting point. Anyway, John, thanks. We've probably explored that.

MR COSGROVE: Let me just touch briefly on this cost angle that was referred to earlier, Mark. I don't want to explore this in great detail today, but we have a document prepared by Phillips Fox, an actuaries and accountants group, who actually appeared before us in Sydney last week. This document, which is all about costs and benefits to the community as a result of choice of superannuation fund legislation, which is still before the parliament, of course, has some material in it about the costs of the various types of funds. The figures are somewhat different from those in your submission. They tend to indicate that the costs of the corporate sector relative to the assets it has under its purview is something just over 1 per cent and also - again I won't go into the details - the gap between that type of cost for a corporate fund and for a for-profit fund or a retail fund is a little narrow that in your submission. But I wondered whether we mightn't, with your agreement, perhaps provide a copy of this to Nicholas and ask him if he'd like to give us any reactions to it.

Related to that is a point from another submission which we'll be discussing later in the day from William M. Mercer. The particular material in their submission is - I guess "assertion" may be not quite the right word but there's no precise evidence in the submission to this effect. But they do say that one of the reasons why the decline in the number of corporate funds has occurred is the significant increases in cost, both dollars and employees' time, involved with running a superannuation fund, and they go on to say that the demise of corporate funds which are generally run on a not-for-profit basis and are often heavily subsidised by employers will result in employees participating in master trusts or higher cost retail funds. It was that phrase "heavily subsidised by employers" that caught my eye, and I'll be asking Mercer's representatives whether they have any evidence to that effect, although I do recall there is some material in the Phillips Fox document which actually quantifies or attempts to quantify the subsidy. It varies from about .1 to .2 per cent of assets. But are you able today to give us any information that would help us on this point about subsidisation of the operation of the funds?

MR CERCHE: If I can go to your first point, I don't think we're far apart in our figures.

MR COSGROVE: No, I wouldn't say it's big, but it's not insignificant.

MR CERCHE: We say minor corporate funds. It's 1.22. For medium and major corporate funds it's .7 per cent, and I think the distinction there is the important one. The costs of a corporate fund are fixed, that is, you have one secretary, you have one - so the bigger the fund and the bigger the number of dollars, the less cost, whereas typically a master trust doesn't work that way at all. It's the bigger the dollar, it's the same percentage cost. That's the commercial advantage that the corporate funds have and that's how their cost structures are quite different. I get a bit passionate about this. Figures are figures. People say, it's 1.22. That's not so much," but it's 1.22 per person account balance but it's a hell of a lot, a truckload of money, if you're talking about 100,000 members. Then the amount being charged bears no relation to the cost. So that's the first point. The second point is employers do subsidise their funds directly and indirectly. Typically in the older days it didn't matter because the employer was on the hook for the costs, whatever costs, so in the pure defined benefit scheme it was all employer costs so the employer took responsibility of organising it in the most efficient way it was. The move away from defined benefits has been slow; a lot slower than a lot of people realise. There are still very significant superannuation funds out there which provide defined benefits which costs the employer nothing and will cost the employer nothing because of the surpluses that have developed over the years. So they're the ones that are properly run and these ratios don't really mean much.

Typically, however, there is support for the employers who are keen on and see superannuation and their own fund as an advantage in the marketplace. There are employers out there who still think that way, still think that way passionately.

MR COSGROVE: In terms of their industrial relations with their workers?

MR CERCHE: Yes, and interestingly, and I don't need to name funds, but the public sector spin-outs have very strong corporate funds and support them very strongly as a part of their industrial matrix if you like. They're very successful at it and they're the best. You know, they are models of what people can really aspire to as to the efficient delivery of an integrated employment arrangement. So there is support. I couldn't put a dollar figure or a percentage figure on it. I think it varies significantly. I would say though that corporates are looking more at their bottom line and are seeing the opportunity to move more of the cost into the fund as opposed to on their own account and they have still got a weather eye out for the costs though, and typically they are outsourcing a lot of the functions but still retaining the control inside the organisation and inside the equal structure to the benefit of themselves and their employees.

MR COSGROVE: Okay.

MR BROOKES: Commissioner, may I just - - -

MR COSGROVE: Yes, Nicholas.

MR BROOKES: To your good points earlier, the number of corporate schemes certainly has been reducing but I think tying in with Mark's comment about the large corporates I think what's becoming clear, there's a differentiation emerging even within corporate superannuation in that the large funds whom we represent are very different in a lot of ways from the smaller funds. There are 2100 corporate schemes roughly in Australia with $80 billion between them but the top 50 of those, or in fact less than top 50 whom we represent, represent over 70 per cent of all those assets, so that's only 50 out of 2100, so it's a very small - it's, what, 2 and a half per cent, represents 70 per cent. It's a critical point because I think to some extent Mercer's comments are correct. Mercers of course are one of the largest master trust providers, service providers in Australia. Their comment is accurate that there is a movement away, not by corporates, I qualify that. Small is the word I would put in. The very fact that we have existed for three and a half years that we created deliberately to represent the key interest of the large corporates. I think there's a critical point. I don't want to over-elaborate.

That impinges on costs because if we then look at all these variations of figures, you know, where is the Phillip Fox survey drawn from. I'm not questioning at all their figures. I'm just saying where is it drawn from, what size, what's the average size, what's the range. Again, that comes back to costs because we know that the difference in costs is a critical thing. Not for us because it doesn't matter to the corporates. They're not in it to make money. It matters to individual Australians, the individual Australian community. I just put this squarely on the table. If there is even .1 per cent per annum difference in cost reduction that's actually $80 million. Let's put it on the table. $80 million for every 10 basis points moved. Now, if we are 30 basis points or 50 or 70, you can see the scale of money we're talking about, and the choice is, and that's somewhere between 80 million at 10 basis points through to 560 million at 70 basis points, that's the quantum of profit that is either in individual Australians' retirement accounts under the not-for-profit site, under SIS, either that or that 560 million or whatever the figure is is actually shareholder profit for the financial service providers.

MR COSGROVE: Thank you. Let's come back to SIS again. Again, Mark, you said it was broadly an appropriate framework but it did contain some silly rules. Now, you know we have a number of aspects of superannuation excluded from our terms of reference but can you identify any particular elements of SIS which are within our terms of reference that you would see as in need of an amendment?

MR CERCHE: I think the Part VIII associate provisions are so complex that nobody can make any sense out of them. I think that's fair. They're designed, I believe, to stop superannuation funds investing in the employer sponsor or an associate of an employer sponsor, and we're really talking there I think about some of the cherry picking funds of a bygone era where the employer sponsor would make contributions for a member, omit to tell the member that they were making contributions, and lend the money back to the company.

MR COSGROVE: Unfortunately that is one of the pieces of legislation which is excluded from our terms of reference.

MR CERCHE: Indeed, but that's what it was all about, but it's so complicated that it means for example that a firm of solicitors who has a corporate fund can't accept contributions for SGC payments for a partner who happens to be a director of a bank, for example, because then it becomes an in-house asset and the associates of the - or indeed more relevantly, without bringing it back to a particular firm, an investment company such as AFEC or Jerrawurra, so those sort of little inconveniences mean that where it couldn't possibly be suggested that this publicly listed investment company is associated with a firm of solicitors, the fund is prohibited from accepting

SGC contributions and directors' fees into that fund. It has to make some other arrangement which is - I mean, it's just an inconvenience.

One of the other things which - and this isn't in the legislation, it's just an APRA requirement - my understanding is that APRA expect a trustee to establish on a monthly basis whether somebody is in employment at the relevant number of hours which is just an impossible requirement. I can't believe that that is a serious requirement of APRA but it sounds like it is.

MR COSGROVE: Yes.

MR CERCHE: What other rules are there? You have to look at the borrowing rules and say, "What are they there for," because every other type of investment admits of borrowing. Managed investment schemes certainly do and you overcome the - every company in Australia is geared to some extent so why can't a superannuation fund borrow? The answer of the regulator is, "Well, we think it exposes the fund to unnecessary risk." Borrowing doesn't expose it to risk. It's the underlying investments that do that in my opportunity but that's a broad government issue which is beyond my - - -

MR COSGROVE: No, that's useful, thank you. On page 16 of your submission under the heading Risk Associated with the Absence of Asset Backing for Trustee Boards, you have a statement there which in effect I think you have already mentioned in passing:

> In the event of a systems failure or other collapse the required asset base is unlikely to be adequate to make good the damage. The required capital backing for these entities serves more as a barrier to entry to the approved trustee function than as a practical source of financial insurance.

Do you see that as a significant barrier to entry? As I say, effects on competition of the legislation is one of the things we have to give prime consideration to.

MR CERCHE: Well, actually I do. If we looked at the typical corporate fund they would be a $2 company because it was set up to comply with SIS for no other reason. Previously we would typically be individuals and in order for lump sums to be provided which is the fashion these days, or was the fashion in 1993 and continues to be the fashion, it was necessary to establish a corporation and where was the capital for that corporation to come from? The short answer was the company set it up and the company was prepared to tip in $2 and actually give a share to the employer directors, and we comply with the law and off we go. But if it was suggested that the employer sponsor should tip $5 million into a company then the answer to that will be, "No, of course not." So the capital, to meet any capital inadequacy, will either have to come from another source, most notably the fund, or the rule will have to be circumvented by paying some money to a bank usually and the bank will give a guarantee and the bank will insist that you deposit the same amount with the bank as is covered by the guarantee so $5 million just goes out of the system for no real benefit. The answer is insurance. The answer is not capital. Insurance is a bad word in Australia as we see but the answer is $5 million isn't enough to cover a serious failure.

MR COSGROVE: Yes.

MR CERCHE: In most cases for anything less than 5 million it's more efficient and cost effective for the fund to carry the risk and typically they do by way of the indemnities which SIS permits a trustee to enjoy. Absent fraud and a deliberate or intentional failure to meet the standard then the fund pays. By and large that's the most efficient way of covering small losses. In the context of a superannuation fund of the type I'm talking about, and most vibrant funds as opposed to some smaller funds, $5 million is deductible in any event in most cases.

MR COSGROVE: Are you aware of any instances in which somebody wanting to operate under an approved trustee structure has been deterred by the reserve requirement?

MR CERCHE: Yes, I certainly am, absolutely. One fund actually sought to become an approved fund and ran into this very issue, being unaware of the requirement at the start of the process, but found that it couldn't justify the cost for the benefit that they thought that they were getting from being a public offer fund. The truth of the matter is without a huge advertising budget, a public offer fund is not going to get any money from anybody other than its natural drainage area if you like. These funds which become public offer fund on the basis that they will be able to attract money are bluntly kicking themselves, and they don't, and they fail. The funds that catch the public's money as opposed to the employer sponsored money or the award money are those funds which spend many millions of dollars advertising on television and who pays for that?

MR COSGROVE: In your experience, Mark, would cases such as the one you mentioned of a fund being deterred be rare or more common?

MR CERCHE: I know personally about two. I was going to say three but I know of two where they have abandoned. I know one which pressed on and has regretted it to this day because of the custody requirements and the fact that they overcame the capital adequacy rule by having the custodian write the cheques. Of course, the difficulty with that was that the cheques were always late, they were wrong and had to be redone, and the service level dropped down, because this was a relatively small professional bodies fund - not professional, professional body - which had to become public offer, because the members were not employees; the members were self-employed persons, so they didn't fit within the traditional SIS 23JA fund, for those of us with grey hair.

MR FRENEY: I can't resist the temptation just to come back to the point, though, that whatever the tangible asset requirements are and what entry they may preclude, I really think in terms of the prudent management of a superannuation fund and protecting member interests one of the biggest risks can be the operations risk and the wherewithal to remedy some kind of operational breakdown. We have seen instances where you have well-intentioned people trying to deliver superannuation services where they might have been going through some sort of change process, change of a computer system, that leads to trouble and the financial capacity is just not there to remedy and to prudently manage the superannuation fund or a changed situation in a superannuation fund.

I think in terms of the principal objectives of SIS, of prudent management and protection of member interests, to my mind barriers to entry in terms of net tangible assets are one thing, but being able to manage operational challenge and operational failure is another very important consideration.

MR CERCHE: Absolutely, and I think you'll find that most major corporate funds are certainly operationally superior to their commercial counterparts. The reason for that is that they have the wherewithal and the money to make sure that the service providers provide. It's very rare now - there are exceptions to this; some corporate funds have set up their own administration systems and they have the capacity to do that, and those are usually okay in the terms that we're talking about. But if the administrator mucks up, it's the administrator's costs, not the trustees, and most properly-organised funds would make sure before they committed to a particular service provider had (a) the capacity to do it and (b) the capacity to pay if they couldn't do it. There may well be instances where Joe Blow Electronics, a three-person or four-person APRA fund, has been unable to run a computer system, but that's somebody who shouldn't be doing it anyway.

MR BROOKES: I agree with your point and that's much the same thing, I think. But that's why the predominance is to outsource - is from the corporate trustee board. For focal reasons that Roger has actually brought out, and they're excellent reasons, the due diligence for the trustee under SIS actually ensures to the optimum extent that the optimal service provider is chosen and fired and another one taken on, and we welcome, by the way, in terms of this Productivity Commission, looking at ways which can improve the quality, the accountability, deliverability of the commercially different service providers. I think your point is excellent, because really the tightening surely should be on the service provider, because that's where the ball most likely will be dropped.

MR FRENEY: Although the trustee is the responsible entity, and, you know, it's a daily operation, running a superannuation fund, and you wonder whether indemnity provisions and insurance provisions would kick in early enough to actually save a situation of an operational - - -

MR CERCHE: Usually they do, because there's a zero deductible in the contract with the service provider if the administrator breaches the service standard, or fails to achieve the service standard, there's zero tolerance. It's not like if there's a deductible claim, where the insurance usually doesn't kick in until it's a real number. So there's a balance there. Most corporate funds, because they've been at it so long, have the systems in place to cope and to administer properly and prudently, and they're there. They're there in a big way at the moment, and they're functioning and meeting all service standards and exceeding most service standards of anybody else in the business, and it would be most regrettable if the outworking of this and the intention of this is to close them down.

MR COSGROVE: Could I come back to our friends, Mercers: in their submission they have this statement - - -

MR CERCHE: Could I declare an interest here, chairman?

MR COSGROVE: Yes.

MR CERCHE: I'm Mercer's corporate legal adviser.

MR COSGROVE: Thank you for mentioning that, but I don't think it affects my question.

MR CERCHE: It might affect my answer.

MR COSGROVE: Okay. They say:

> The increase in legislative requirements in the last 10 years has hit defined benefit funds far harder than accumulation funds. In new legislation, defined benefit funds are often an after thought, with such funds being required to comply with extremely complex and unsuitable requirements.

Now, they don't really make clear exactly what legislative requirements they're referring to there, and I'll be asking them that this afternoon, and it may well be that they have in mind a lot of the taxation legislation which many people have been identifying, and I think you did yourself as a major reason for additional complexity and compliance. But I'm asking this question again, against the possibility that the SIS Act itself might in some way, by virtue of amendments to it, or possibly even issuing of circulars by APRA, might have introduced some degree of competitive disadvantage for the defined benefit schemes. Are you aware of anything in that area?

MR CERCHE: Well, the information requirements that SIS mandates are relative to piggy banks, bluntly. They don't talk in sensible terms about benefit accruals and those sorts of things. It's account balance at the start, the insured benefit and all that sort of thing, and so the defined benefit funds have to tailor their information to provide the required information, then the relevant information. That's an illustration of the point, but I think Mercers are probably talking about tax, without wishing to limit them in that, but that would be my assessment. But certainly in the SIS legislation you can see four or five pages devoted to insolvency of defined contribution funds, which shouldn't be insolvent at all, to half a paragraph dealing with defined benefit fund insolvencies, which of course are the only ones that can be insolvent, if you come to think about it. A defined benefit fund, the accounts should equal the assets, if properly managed. The deficiency occurs when that is not so, and that is not so because the trustee, for whatever reason, isn't valuing the assets properly.

MR COSGROVE: Okay, thank you. One aspect of the equal representation requirement is the possible additional costs that the trustees might face in terms of obtaining employee representatives, or perhaps in terms of the rate of turnover of employee representatives. Have you any comments to make on that score?

MR CERCHE: I don't think there's any costs. I can't remember any - - -

MR COSGROVE: I meant the cost of conducting an election, for example, that - - -

MR CERCHE: The average election costs, I would think, in the region of $10,000, for a large fund, you know, a 10,000 member-type thing. Elections of member reps is pretty organised and not terribly expensive. I've never perceived that to be an issue. It's often been difficult in smaller employers with larger boards to get the required numbers, and the people, you know, there is a - it's like every process, people stand for election because (a) they think they can do it, or (b) their workmates think they can do it and persuade them to do it, but there is a general reluctance, or there can be a general reluctance to take on what's perceived to be an onerous obligation. That's the one side of the coin. On the other side of the coin you see fierce election propaganda material for people who want to be elected, particularly in the larger funds. Not perceived as a problem, and so far as I'm aware, I can't remember a corporate superannuation fund paying $13 million redundancy benefit to a finance director.

MR COSGROVE: In terms of turnover of those representatives, would the typical arrangement be that their successor was appointed without an election?

MR CERCHE: The electoral rules typically require the filling of a casual vacancy within a period, and the rules themselves which are adopted by the trustee usually have a mechanism for determining that, and it's the next candidate.

MR COSGROVE: I see.

MR CERCHE: The next candidate who would have been successful but for that candidate, and so there is - - -

MR COSGROVE: I see, a relatively inexpensive way of doing it.

MR CERCHE: Absolutely, and the trouble with having an election out of time is the stagger. So it would be a very rare fund indeed that had an election for a casual vacancy. There would be usually a detailed mechanism for replacing a person, and in fact a lot of unsuccessful candidates are still interested in the fund and are still kept up to speed with things because of changeover of people.

MR COSGROVE: The final question on that point: is has the introduction of strict liability resulted in any diminution in the number of people willing to put themselves forward for appointment as a representative trustee? I realise it's a relatively recent requirement.

MR CERCHE: I couldn't say that it had at this point. I doubt that it will. Strict liability simply means if you're prosecuted, you have no defence, that's all. I mean, the objective is to comply, not to breach, and I think, I'm proud to say, in the corporate area where we're involved, there is compliance at the highest order.

MR COSGROVE: I have a final question - Roger may have some others - that concern the requirement upon us to give consideration to alternative means of achieving the objectives of the legislation, and one of those which we discussed with people in Sydney was the possibility of a dual structure whereby at least large retail providers presently subject to obligations under the Managed Investments Act might operate under that act, and their superannuation legislation requirements would be sort of tacked onto that. So that would essentially free them of the need to adhere to the Managed Investments Act and the separate SIS Act, and there is quite a bit of similarity in parts between those two pieces of legislation. Then for the smaller end of the market, and I'm not quite sure how this would fit for your large corporate members - that was the reason for my question - but the smaller end of the market would remain under SIS, because, you know, they have nothing to do with the managed investment structure. Do you have any thoughts on that?

MR CERCHE: I have no difficulty with the for-profit side of the business being regulated somewhere else.

MR COSGROVE: But you would see your own large corporate members being better suited under SIS, would you?

MR CERCHE: Yes, because we don't offer managed investments.

MR COSGROVE: No, no, right.

MR CERCHE: In fact we don't offer much, we accept. This is one of the things that is very hard to discuss, because we're talking at cross-purposes. We don't offer products. We receive contributions. We exist to assist our members. We don't exist for ourselves.

MR COSGROVE: Yes, I can see the point you're making.

MR CERCHE: The managed investments regime and us have very little in common.

MR COSGROVE: It's of no relevance to you.

MR CERCHE: Yes.

MR COSGROVE: Okay, thank you. Roger.

MR FRENEY: Thank you, two questions. One, I was very interested in the description you gave of a funds administrator, I think it was, who operated both in New Zealand and in Australia and was saying that his work under the SIS regime in Australia was no more expensive than it is in New Zealand where there isn't an SIS equivalent which was sort of suggesting that SIS was not imposing significant additional costs on the administration and compliance. I was just wondering whether it's possible to generalise that any further. You gave the example of one administration manager. Would you say that would be a typical experience or would it be possible to get a slightly more general handle on that?

MR CERCHE: As I said I think in my opening, SIS has not been an issue for us. It's a set of rules that you either elect to comply with or you don't play the game. The area of concern is when you don't understand the rules because they're so - dare I say it - poorly drafted. If anybody could explain to me how the Part VIII associates provisions work, I will employ them.

The second point is that it's a regime which the government has said you must comply with, so you set up your systems to do it. It's only around the edges when you get changes that there's any real difficulty. For example, when you alter the preservation age to get a sliding scale for people, you have to identify in your fund now and at point of entry who is subject to the sliding scale preservation rule, so that's a systems problem which typically doesn't affect a corporate fund at all because it says to its administrator, "Comply with that rule and demonstrate it to us if you have." Where the administration is handled internally, it's usually backed out into the corporation systems and the same rule applies. Very few corporate funds now don't have an administration agreement with the corporation if it is in fact providing services, which puts the same sort of test on the corporation, and the corporation fails to achieve the benchmarks at its cost. So if you had the directors of most managed investment schemes in here asking about these issues, they would say, "That's an administration matter," and it wouldn't concern them, nor it should. The experts and the detail should be attended to by the people who are responsible for that and the directors' role should be to make sure that it is in fact being done and be satisfied that it's being done. SIS is not an administrative problem for a complier. I mean, there will be some rules you don't want, but that's not the question. The government says, "You've got those rules," so you meet them - not a problem, in my opinion.

MR FRENEY: Thanks very much, Mark. My last query was really one of clarification. In your submission I think the gist of one point you were making was that if superannuation services are provided by a for-profit entity as compared to a not-for-profit entity, that some of the benefits that the members receive in a not-for-profit scheme and particularly a defined benefits scheme, these are benefits over and above SG that the employer might be giving to the members, but those benefits would not be available in a for-profit regime. If there was a shift, say, from a not-for-profit to a for-profit situation, the implication was that the members would lose some of the "additional" benefits. I couldn't quite follow whether what you're talking about there was that there were employer contributions over and above the SG amounts or whether there was the extent of the subsidy from the administration angle or what it was, and I was just wondering whether you could elaborate because if that's a significant issue, it's certainly something to bear in mind as we look at the industry trends.

MR CERCHE: It's very clear that the employers typically have sponsored their funds in excess of the SG minimum by a considerable margin and have additionally supplied at no cost or very reduced cost the infrastructure to provide those benefits. That still happens. A lot of corporate funds have gone from defined benefit to defined contribution and they haven't typically gone back to 8, 6 or 7 per cent or whatever the SG level was; they have picked a figure which produced actuarially - making assumptions as to returns and salary growth - that if an employer contributed, say, 11 or 12 per cent, at the end of 30 years the account balance should equate to the defined benefit. That's typically how you convert out. The employer has said and there are two types of employers. There are the employers who have stayed in the defined benefit fund and I will come back to them and then there is the employer that has gone out and has converted on this sort of basis. They have said to the employers, "Please agree to change" - one possibility - or (b) "It's going to change if we have the power to do it."   But to keep people on side and the superannuation is perceived by some people to be a real employee benefit in this country, despite the taxation.

What the arithmetic was, we will contribute 11 or 12 per cent because the actuary tells us on the rate of return looking backwards and going forward and salary growth, it will be the same. The slight of hand was - it wasn't a slight of hand, they were told - but bear in mind the investment risk is now with you. So if the rate of return doesn't achieve the assumed rate, then it will be less. On the other hand, if the rate of return is higher, you will get the benefit of that. So that is one scenario in the corporate fund that has happened and the employer still has a keen interest in the performance of that fund, because there is general disgruntlement if the objective isn't achieved, if the investment performance is better and the benefit is greater, then the employer is going to think, "How can I reduce my contributions going to a lower rate?" That is a separate restructuring if you like.

But if the investment performance is under that, then everybody starts to look at the conversion and you will see whether there is an action under the Trade Practices Act or something similar to that. So employers have a keen interest in making sure that their defined contribution plan performs. Equal representation gives them that entree. It makes sure that the investment strategy adopted by the trustee is consistent with the outcome that was promised to members or indicated to members. But where the employer is on the hook financially in the defined benefit arrangement, the focus is much more acute, because if there is an under-performance, then it is a direct cost to the employer. If there is an over-performance then it is a benefit to the employer.

So a lot of employers have still stuck with those arrangements, certainly in respect of current employees when they decided to go to another structure. When the arrangement goes out-house, all of those considerations go out the window. The employer typically says to the employee, "You are going out to a master trust, we have to contribute 8 per cent, you can salary sacrifice any other amount you like and we will give you a one off salary increase" - if they are good employer - "or we will give you nothing. It's up to you." The net result of that is that there is either a one off salary adjustment and the employer's contribution is SG, unless it is sacrificed out of other income, which is typically what happens. Then at that point there is no employer sponsorship or assistance in relation to the fund at all. The cost of the fund and its investment performance is entirely on the employee.

MR COSGROVE: So generally if an employer reviews the company's superannuation arrangements and begins to contemplate the future of them, including perhaps the outsourcing to a master trust, typically do they decide not to persist with the defined benefit?

MR CERCHE: Absolutely.

MR COSGROVE: So at least for new starters. It might just be closed and perpetuated for existing contributors, but - - -

MR CERCHE: A handful I think - - -

MR COSGROVE: So very few defined benefit funds would be trusteeship change to a master trust arrangement?

MR CERCHE: No, taking a step back and going forward, there are some master trusts out there which offer defined benefit funds and there are some employers who have as a first step moved it out to the master trust by way of successor fund, because then you don't need employer consent and then you can stop it without employer consent. So there are some of those about, but typically an employer would not support a defined benefit where it had no say in the investment strategy and in the master trust it doesn't have the necessary say. While there may be a few out there that are closed, where there is a defined benefit component in respect of past service and there are certainly some of those where it couldn't be otherwise, there are a handful I suspect of defined benefit funds which are ongoing, but they are probably funds where an unallocated reserve has been transferred, because the transfer in fund was in surplus. Typically the employer sponsor there would maintain the defined benefit until the surplus was exhausted, to avoid a fight over it and then once it was in balance it would be converted.

So it is a delegate sort of thing and one of my experiences I guess is the way the legislation has moved to discourage defined benefit funds and I agree with Mercers sentiment there and it's not necessarily only SIS, but there are elements of SIS that do it and I think that's to the detriment of participants who have enjoyed the security the defined benefit fund offers.

MR COSGROVE: Do the successor fund rules in SIS have any relevance in this context you have been discussing?

MR CERCHE: APRA's interpretation of the successor fund rules have caused a great deal of hair loss, because it's an extraordinary position which they have been unable to shift from. My general view about the successor fund provisions are that they have been - and this is a chairman of the CSA as opposed to a lawyer - have been sometimes inappropriately, not hopefully by my client, but they have been used as a method of avoiding liability and converting and under the guise of outsourcing have radically altered the nature of the benefits without a full description of the change, if there was a full description at one end, message not received at the other.

MR COSGROVE: Does that suggest a weakness in the way the provisions are drafted, or is it simply - - -

MR CERCHE: The provisions were designed, were intended to apply so that you could en masse move a fund from here to here without changing it and member consent wasn't considered necessary in those circumstances. But of course that is almost impossible to do. So you have the equivalent concept built in and then you have equivalents to rights to benefits at the point of transfer built in and then you have academic arguments as to what you mean. The rule should be, unless it is identical you should get members consent and if you can't do it you can't do it. I think there have been abuses of it, to the detriment not of the employers, but the legal system is robust enough to recover that as we have seen in the United Kingdom. These things won't be hidden forever, but there has been abuses of those provisions. Those provisions have worked efficiently on the other hand when it has been properly done in a small defined contribution plan where it is no longer efficient to maintain the arrangement in-house, because of the regulatory burden, so you outsource it and provided you get the investment strategy more or less right and you get the insurance arrangements continuous and more or less right, there should be no problem. It is quite efficient and you avoid going out and getting the 50, 100, 200, 500 signatures, which is what you would otherwise have to do.

But where the successor fund provisions have been used to convert the type of fund and the employer's obligation, then in my opinion that's an abuse and fortunately I've not done any myself, but I have looked at ones that have been done which haven't complied.

MR FRENEY: That completes my questions, thank you.

MR COSGROVE: Thanks very much for a very extensive and informative discussion. We will follow up in due course on the cost angle you mentioned. Thank you very much for your submission.

MR CERCHE: Thank you for the opportunity.

MR COSGROVE: Our next participant is Tower Trust. For the purposes of our transcript we would like you to identify yourself in the capacity in which you are appearing.

MR O'BRIEN: My name is Pat O'Brien. I am the general manager personal business for Tower Trust, based in Adelaide.

MR COSGROVE: We have received your submission. Are there any particular points you wanted to make?

MR O'BRIEN: I think the thrust of the submission is really to bring someone's attention to the change in the lodgment period. That is the real issue for us of course. It has been brought forward from nine months back to four. We are currently in the process of implementing a computer system and they never go smoothly. We have also got issues that a lot of the investments within private funds we administer are in managed funds and some of those managed funds don't provide final tax statements until as late as October, which of course presents its own difficulties.

We have put it to the auditors that if we were to lodge on a cash basis rather than accruals basis and give an estimate of the tax liability, we might have a chance of meeting the four-month deadline, but if APRA are not prepared to accept on that basis and certainly Price Waterhouse are prepared to sign off on that basis - but if APRA aren't prepared to accept, then we have a few problems. Then of course that ties into the levies, but of course I don't think you are looking at levies.

MR COSGROVE: Remind me if you would when this reduction in the lodgment period to four months has effect? It is already in place?

MR O'BRIEN: Yes, it was in for the year ending June 2000.

MR COSGROVE: June 2000?

MR O'BRIEN: Yes.

MR COSGROVE: So returns are due by the end of - - -

MR O'BRIEN: By the end of October last year and we failed dismally in that lodgment, but APRA have been quite supportive in that, quite understanding.

MR COSGROVE: So there have been no additional late lodgment fees levied on the funds?

MR O'BRIEN: Not at this stage. I gave a submission to the Department of Treasury and they came back and said they would be very surprised if APRA would impose penalties. So I guess we - - -

MR COSGROVE: In respect of the last financial year only?

MR O'BRIEN: Only, yes. This particular year they have been quite open and said, "Well, you have had your go and now - - -"

MR COSGROVE: The expectation is that they will be quite demanding for the year - next month?

MR O'BRIEN: 2001, yes.

MR COSGROVE: Anything else you wanted to say to us?

MR O'BRIEN: That probably in a nutshell is it. One of the recommendations at the back talks about the difference between the legislative treatment of self-managed funds and the SAFS that we administer or at least specialise in and I suppose we also administer self-managed funds and really we treat them very much the same, apart from who is the trustee. So I guess we are a little bewildered I suppose between the difference in the lodgment and also the levies. I suppose what we are asking for is a level playing field and the suggestion that we have made is because the ATO obviously had expertise in processing so many of the self-managed funds, that maybe the SAFS can also be processed by them, but we still fall under the APRA credential banner.

MR COSGROVE: Yes, it was that point really that I wanted to ask you about. You do say the current rules discriminate against the SAFS. I take it as you have just been saying that there are two elements in your view which form that discrimination and one is the different lodgment date and the other one the different levy. Nothing more to it than those two items?

MR O'BRIEN: No, that's about it. I mean if they were self-managed funds the levy would be about 200,000, whereas now we are paying 1.5 million. A master fund pays a maximum of 46,000. So there is in our mind inequities.

MR COSGROVE: Are you aware, Pat, of this discrimination actually resulting in a shift out of SAFS into SMSFs?

MR O'BRIEN: There has been some movement, but not a huge amount. I think our numbers over the last two or three years have been growing moderately, certainly not the growth that we used to have and the self-managed funds are also growing, but they are coming from different sources.

MR COSGROVE: So would it be reasonable to conclude that the small APRA funds see sufficient benefit in operating with an approved trustee for example to offset the additional reporting obligation and higher levy they are required to pay to APRA?

MR O'BRIEN: Yes, at present we certainly believe that people have made a decision that they don't want to be trustee, but of course cost is a huge factor and sooner or later people will move, more so than they are doing now.

MR COSGROVE: As you said, you have put forward some recommendations to us. The first one I think is clear to us that prudential supervision of your trust as an approved trustee would remain with APRA, but prudential supervision of the SAFS themselves should be passed to the ATO. I can see how that might work. Alternatively, the SAFS stay with APRA, but the administration duties associated with regulation of them are passed to the ATO again. The second one again I think I can understand, but the third one, I'm not quite sure of its practical application. This is the one where you are saying that approved trustees such as Tower Trust would continue to be subject to APRA, but not the actual SAFS. I am trying to think how APRA would view such a situation. In other words, in effect it seems that approved trustees would be, if you like, de facto regulators of the actual small APRA funds. Is that how you see it working?

MR O'BRIEN: No, not really. The ATO currently receive returns for self-managed super funds and we are saying that they should also get the returns for the SAFS, but APRA would still regulate us. So in effect all APRA would be doing is outsourcing the processing of the return and all the - - -

MR COSGROVE: To ATO?

MR O'BRIEN: To the ATO and then all the stats would be collated by the ATO and obviously passed on to APRA. But if we did anything wrong in a legislative sense, then obviously it would be APRA that would be regulating us.

MR COSGROVE: Does ATO have the resources to do the type of prudential supervision that APRA is designed to do for these funds?

MR O'BRIEN: Most of the prudential supervision that APRA carry out on us is at a sort of fundamental company level. In other words they come in and they have a look at things. They go through all the minutes and the audit committee meetings; all those sort of things. They have a look at the robustness of the organisation as far as business continuity plan is concerned, or our IT developments and systems and whether things are operating correctly and all the checks and balances internally are there and the returns flow or the administration flows properly, there are delegations from the board. So it's all those very nitty-gritty type of aspects. They don't necessarily look in a huge amount of detail at the individual returns or funds I should say. That really is a function for Price Waterhouse or our internal auditors who write their reports and APRA sort of review those.

MR COSGROVE: So in that sense what you are proposing here might not be such a big change?

MR O'BRIEN: We don't think so, that's for sure.

MR FRENEY: I was just wondering - excuse my ignorance - when other superannuation funds have to report to APRA by? Are they also not the small, the other APRA funds - - -

MR O'BRIEN: The investment funds and those - - -

MR FRENEY: Yes, do they have to report within the four months too?

MR O'BRIEN: Four months, yes.

MR FRENEY: That is a sort of uniform APRA requirement.

MR O'BRIEN: Public office funds.

MR FRENEY: Yes. So are they facing the same challenge as the SAFS in terms of getting this information from funds managers running unit trusts and the taxation information from them within the same time frame?

MR O'BRIEN: I'm quite sure they would face the same problems as us. I know a number of the larger fund managers actually wrote to their clients and told them to request extensions of time with the ATO to lodge their tax returns, because they wouldn't be advised of their income by the end of October. So I'm quite sure the master funds would also face the same problem. The difference is at the end of the day they are lodging one return and we have 5000.

MR FRENEY: The logistics are huge. I just wonder if there is any time limit imposed by statute on the master funds to report the distribution, the 30 June distributions. I would assume there would be some sort of - - -

MR O'BRIEN: I'm not aware of any.

MR FRENEY: This must be a general issue for all taxpayers and superannuation funds, that if they are reliant as I'm aware they are, having to get these distribution statements and tax statements from the master funds, then other people are sort of faced with a time issue as well.

MR O'BRIEN: I think ASIC would probably take a huge interest in those type of organisations, but I'm no aware of anything built into the legislation.

MR FRENEY: So we come back to the logistics of your situation. Have you had any rationale given to you by APRA, or by the treasury as to why they are requiring the four months?

MR O'BRIEN: No, they have basically said that self-managed funds are a different animal and every other superannuation fund has to fall within the legislation and they see it as a test I suppose for the trustee to be able to meet their deadlines.

MR FRENEY: In a sense it can be a test of sound management.

MR O'BRIEN: Exactly.

MR FRENEY: So another issue I suppose that they could put forward and I am just wondering whether there is actually a trustee who is removed from the members of the fund and part of the sort of prudential supervisory regime and prudent management regime as you have said, could be that the regulator wants to be able to assess fairly early on in the course of its annual work where are the risks coming out; where are the weaknesses, the problems in the industry coming out? So in terms of managing their own work load APRA might want to be able to have a timely view of how the SAFS are being managed. So from the annual returns they want to get data from the SAFS at the same time as from other superannuation funds so they know how to deploy, for example, investigatory and supervisory resources of APRA. I'm just hypothesising whether this could be a reason but has this been mentioned to you as a possibility?

MR O'BRIEN: I think you're correct in that. I think that's where they see it. But I suppose we're saying that there are other ways to achieve that, either through reliance on our auditors or by different spot checks or whatever. We've offered to pay the levy up-front in case it was a revenue issue.

MR FRENEY: Yes.

MR O'BRIEN: They believe it's not a revenue issue. We've also offered to provide them with the stats straight off the machine as a sort of master fund if you like, how many funds we've got, what the total assets are; all those different things. But we haven't had any luck at this stage with any of those arguments.

MR FRENEY: So what length of time would a suitable sort of reporting time frame be?

MR O'BRIEN: Well, I suppose what we're saying is if we have this new computer system in place and it's working as it's supposed to be working then we would give October a good go, apart from the fund manager issue. We're asking for the nine months, but as a compromise I would have thought December would give us sufficient time in which to do the whole thing.

MR COSGROVE: Is there scope for you to exert influence on the fund managers to provide the information you need in time for you to meet October - - -

MR O'BRIEN: We have tried that but without much joy unfortunately.

MR FRENEY: And there's only a limit to how far you can take that because you might get sub-optimal investment decisions. If the fund manager says they couldn't meet the reporting deadline and you were loath to put funds with that funds manager then they could be sub-optimal.

MR O'BRIEN: That's right.

MR FRENEY: But it would certainly help to get some clarification overall, John, as to why this four months, if it is simply a standard that the regulators need to have, or whether there's some other some credential sort of reason.

MR O'BRIEN: We feel there must be a different way that we can satisfy them, give them the information they need rather than - and of course even the auditors are saying to carry out their job correctly that they originally were talking November they would finish their work. So a lot of it is outside our hands.

MR FRENEY: Yes, I think we've heard submissions, Mark, from some other people - maybe the accounting and auditing profession - that have suggested that there might be some phasing of returns through the course of the year so you could get a more even distribution of the resources that are required to prepare accounts and prepare annual returns so the regulatory or supervisory timetables could be spread a little differently than all being bunched into one financial year. Presumably something like that would help.

MR O'BRIEN: It certainly would, yes.

MR FRENEY: Thank you.

MR COSGROVE: Pat, a couple of other issues in your paper are worth seeking your guidance on. One is just a factual matter. At the bottom of page 3 I think it is under the Other Matters heading you've mentioned a paper submitted by the Trustees Corporations Association. Could you tell us what that is?

MR O'BRIEN: I think I might have been mistaken. They've got an extension of time until I think the 17th in which to lodge that paper.

MR COSGROVE: Of May?

MR O'BRIEN: Yes.

MR COSGROVE: It's being lodged with whom?

MR O'BRIEN: I understood with your organisation.

MR COSGROVE: I see. Okay.

MR O'BRIEN: Sorry about that.

MR COSGROVE: Right. Thank you. The other one was the investment rules comment in your submission. You say that you think they are fair and reasonable but you go on then to refer to the possible use of superannuation moneys to fund member mortgages I guess. You say that this was a proposal by the government some time ago. Can you recall about when?

MR O'BRIEN: They were talking about three years, four years ago I suppose.

MR COSGROVE: The present government?

MR O'BRIEN: No, I think it was Labor government.

MR COSGROVE: Okay.

MR O'BRIEN: We're talking about utilising superannuation for - but, I mean, I'm quite happy to withdraw this particular matter. I mean, I'm not convinced myself that it's a good idea.

MR COSGROVE: I was going to ask you about what it might mean for prudential management and superannuation funds.

MR O'BRIEN: Yes, it was just feedback that we're getting from some of the adviser groups that we deal with who thought it would be a good idea.

MR COSGROVE: I see.

MR O'BRIEN: I thought it might be an idea to put it forward but I'm not convinced, to be quite honest, myself.

MR COSGROVE: Thanks. I think that pretty much covers what I wanted to ask you. Anything else?

MR FRENEY: No, thank you.

MR O'BRIEN: Thanks very much for your time.

MR COSGROVE: Thank you for coming and giving us your submission.

MR COSGROVE: Well, we get under way again, and our next participant is the Industry Funds Forum. Ian, for our transcript, would you mind identifying yourself and the capacity in which you are with us today.

MR SILK: My name is Ian Silk, S-i-l-k, and I'm the convenor of the Industry Funds Forum.

MR COSGROVE: Thank you. Thank you too for the submission you've given us. Is there anything you wanted to say about it, Ian, or would you like us to discuss it?

MR SILK: I've got some brief comments to supplement our written submission, and then of course I'd be happy to answer any questions on it or the substantive submission. The two key issues that the Industry Funds Forum see as being raised by the issues paper are the overall regulatory framework that currently exists, and to some extent as a subset of that, the operation of the trustee system, and the Industry Funds Forum position on both of those issues is one of strong support for the status quo. Now, that's not to say that we accept and endorse every element of those, but as an overall view, the Industry Funds Forum strongly supports the current regulatory framework, and in particular supports the way the trustee system operates.

The overriding principle of the superannuation trustee system is that superannuation trustees administer funds in the best interests of members, and not in the best interests of any other party, and we think that principle has well served members of superannuation funds in Australia. The Australian trustee system's success is due in large measure, we would submit, to the equal representation requirements that operate. Our experience is they operate very successfully, and underpin much of the member and public confidence in the system. We do not believe that there are any grounds, whether based on competition, efficiency or member interest, that would justify introducing a licensing system for trustees. Apart from the increasing costs of such a licensing system which would ultimately be borne by members of the funds, such an approach is likely to have a negative effect on one of the positive features of the trustee system, and that is the great diversity of individual trustees.

The generally successful operation of industry funds and other funds with member and employer representatives, such as corporate funds, is that the diversity of background, of experience, of skills and of qualifications have served to further the interests of members in a way that in our submission would unlikely to have occurred if there was a different sort of system in place. A spate of recent corporate problems in the non-superannuation field, including Harris Scarfe and HIH, demonstrate that boards replete with what might be called the right type of directors, are far from a guarantee that the shareholders, or those that have a direct stake in the economic health of an entity, are served with those sort of people on the boards. That's not to say of course that they're a guarantee of failure, but it is to say that it's no guarantee of success.

In terms of the regulatory structure, we'd submit that the current regulatory structure has served the interests of members of superannuation funds very effectively and is largely responsible for the smooth operation of a current system, and we would emphasise that we think the Australian superannuation system operates extremely smoothly for the very great majority of members of superannuation funds. The Australia superannuation system is very competitive, and affords members of funds considerable flexibility to tailor a superannuation product to meet their own needs. The current market is characterised by widespread competition, significant innovation, product development of a great scale and considerable flexibility. This includes a range of technological enhancements which aim to and have served the purpose of improving the efficiency and ease with which members and employers alike communicate with their superannuation fund.

Aside from the strong growth in the industry over recent years, including impressive asset growth, there's been an explosion in the number and type of products and services that superannuation funds have provided to members. This activity reflects the reality that this is a competitive industry that provides a very high level of services to members. Industry superannuation funds operate in this competitive environment, and have been one of the key drivers in reducing the cost structures that apply in most superannuation funds. The 2000 KPMG public offer fund index shows that of the 25 listed public offer entities, seven of which were industry funds, the five lowest cost providers were industry funds. Given this situation of modest fees, active competition manifesting itself in significant new product development and strong member support, the Industry Funds Forum strongly argues that it is not appropriate to reduce the regulatory framework in the superannuation system.

The remarks of the governor of the Reserve Bank, Mr MacFarlane, last week, to the parliamentary economics committee, indicated that APRA required more resources and a tighter regulatory regime to tackle the insurance industry and certain limited superannuation funds on the "fringe" of the industry. We think it's important to note that these comments appear to focus on the insurance industry, with a marginal reference to what is expressly said to be a small slice of the superannuation industry that was not part of the mainstream. In the context of Mr MacFarlane's comments, it's inconceivable to the Industry Funds Forum that there would be parties seeking to dilute the existing regulatory framework. We accept and acknowledge that the industry generally, and members of affected institutions in particular, are exposed if a regulatory system is not sufficiently rigorous to protect the interests of investors. The superannuation system, perhaps unlike the insurance system, largely has such a framework in place, and it should be preserved. We would submit that there needs to be a distinction between the establishment of an appropriate regulatory framework on the one hand, and its effective enforcement on the other.

Two specific issues we would raise for the commission's consideration relate to the new penalty regime and to the Superannuation Complaints Tribunal. Industry Funds Forum urges greater disclosure as to how the regulator intends to enforce the penalty provisions, especially in the context of enforceable undertakings and strict liability provisions. There is considerable disquiet that the new provisions are a case of overkill. The Industry Funds Forum would also support the continued role of a statutory complaints body, such as the Superannuation Complaints Tribunal, to be accessed by superannuation fund members. Thank you.

MR COSGROVE: Thanks very much, Ian. The high level of support for the present SIS framework is clear from your own remarks today and also from your submission. Nevertheless, our duty is to, under the terms of reference, look at whether or not it is restricting competition or adding to costs of compliance, and whether those restrictions or costs are outweighed by benefits which the restrictions produce. You noted in your submission - it's on page 2, I think - yes, there's a statement that the act itself, the SIS Act, doesn't constrain competition unreasonably or unnecessarily. I can understand that view, but it would be I think of assistance to us if you could tell us of parts of the legislation which might actually constrain competition. It might get into unnecessary detail today, but if you can't recollect parts of the act by which to do it, you might be able to give us a supplementary note perhaps. It would help us to form our own judgment about whether these things are really, as you've said, reasonable and necessary, which may well be the case.

MR SILK: Well, one of the requirements of the legislation for approved trustees and public offer funds is for a $5 million capital adequacy requirement. Now, in some quarters that is seen - I don't know, some submissions to the commission have argued that that acts as a barrier to entry, and by inference is constraining competition that might otherwise occur within the industry. But the issue, we would say, is that that and any other elements of the legislation that can be pointed to as barriers to entry have to be seen in context, and the issue here is a balance, on the one hand, between a competitive industry that does not have unnecessary barriers to entry, and does not have inappropriately high costs, and a system that has a regulatory regime that protects the interests of the key participants. The key participants are not the funds, they're not the people who work for the funds, they're not the service providers, they're the members, and what we're saying is that to the extent that there are barriers to entry, such as the one I've just indicated, in the total context of the regulatory regime applying in the system, they serve a very useful purpose for the key stakeholder, and the key stakeholder is the member.

MR COSGROVE: Yes.

MR SILK: Too often in these sort of debates there's focus on a party not being able to participate for one or other reason. I might, for instance, complain that I can't practise as an architect. I've got a pen and I've got a pad, so I can sketch, so make me an architect. Well, it's a good thing for people on the 28th floor of this building that I didn't design this building, and that's an extreme case of the balance that I'm talking about. I could argue there's a barrier to entry to me practising as an architect, and so there is, and so there should be.

MR COSGROVE: Yes. So you're not really aware - although we may pass across a couple as we work through your submission - but in general you're not aware of any parts of the legislation which you see as in need of overhaul or amendment because they might be adding unnecessarily, say, to compliance costs.

MR SILK: We're in fact compiling a list of areas that we think this commission can turn its mind to if it wishes, in terms of its final report. But our substantive submission and my comments today are directed to the thrust of the legislation and the thrust of the commission's terms of reference. The issues that we'll provide in a supplementary submission are marginal.

MR COSGROVE: Okay, thanks. I'll look forward to that.

Independent trustees -

you say at the bottom of page 2 and over on to the top of page 3 -

> have been central to a reduction in the reporting of corporate failures in the case of corporate superannuation funds at least.

Can you actually provide us with any evidence to that effect, Ian, again, not necessarily today but - - -

MR SILK: Yes. Look, I probably can't. I was conscious that that was a particular comment that doesn't have empirical data to support it, at least that I've been able to establish, and it relies on comments that have been made to me by people who are more knowledgable of the corporate area than I am, but I don't have any data that I can provide to the commission on that.

MR COSGROVE: No, well, we have had earlier today the Corporate Super Association basically making the same point. In a way of getting back to the point with which I began, under the section Costs of the Legislation on page 3 you say that:

> Whilst we would support measures to simplify the legislation, we wouldn't support any such measures that had the simultaneous effect of reducing security of members' superannuation investments or undermining public confidence -

as you've said to us. But that statement, "We would support measures to simplify the legislation," is again caught up with these marginal proposals that you'll eventually put to us?

MR SILK: Yes, that's right.

MR COSGROVE: Fine. The next point I had was on page 4 under Trustee Rules.

There in the second paragraph you make this statement:

> Aside from the obligations under the various superannuation legislation and regulations, there are duties imposed by the Corporations Law which are entirely appropriate and do not constitute an excessive burden or involving excessive costs.

What exactly are those duties? I'm not familiar with the Corporations Law. Is this the coverage of general duties under trustee law or is it something else?

MR SILK: No, it's essentially that. I'm talking about the general provisions in Corporations Law which require directors in particular to exercise or oversee in a prudential fashion the entities that they have legal responsibility for.

MR COSGROVE: I see. But the SIS Act itself is in this respect adding something, is it, over and above the Corporations Law obligation?

MR SILK: Yes, we believe it is, and it's in the context of trustee directors exercising their duties in charge of a trust and what we would see is the additional level of responsibility that a trustee has as opposed to a normal director.

MR COSGROVE: I see. I think on the final page you say there that:

> Having regard to the sound history of the larger funds, the calibre and reputation of their service providers and their ready availability to be open to request for information from the regulators, more of the regulators' time should be devoted to small superannuation funds.

Well, I guess it's right that the smaller funds may well be running higher risks than the larger ones which might have perhaps more professional management. But equally if a large fund was to fall over you've got a larger loss for the members and the beneficiaries.

MR SILK: Yes.

MR COSGROVE: And of course we've had the CNAL case. But you still would feel that the regulator should in a sense go easier - that's not the right word - but devote fewer of its resources to supervising large funds than the small?

MR SILK: The point you make is a very sound one. A large fund, by definition, if it falls over, it's going to have a more significant effect than if a small fund falls over. We're not suggesting by any means that large funds should escape rigorous scrutiny from the regulators. What we are saying though, if all the resources are focused on the larger funds for the reasons you've outlined, then there may be an exposure at the other end of the market. We've had discussions with APRA on just this point and they make the point that they have limited resources and have to deploy them as efficiently as they can, and I think you can probably make a case both ways. We're really suggesting that APRA should take into account not just potential problems that might occur if a fund falls over but also a likelihood of any individual fund falling over, and both factors should be taken into account when they're setting out their audit plan in particular.

MR COSGROVE: This is not something that the act itself mandates, is it? It's a matter more of the implementation practice of the regulator, right?

MR SILK: That's right. It's really APRA's internal management of their resources.

MR COSGROVE: Okay. Anything else?

MR FRENEY: Yes, thanks, John. The community's interests in super are for efficiency and low cost, and one of the important things that comes up in community discussions I think is about the capacity for individuals to consolidate their superannuation and the question of portability comes up. There's plenty of discussion about how we should try to improve that question of portability, consolidation and release of superannuation balances from one fund to another. I think quite some progress has been made in achieving smoother transfers of funds from one fund to the other. I'm just wondering if you have any comment on that or whether you think it's an area that should be addressed by legislation.

MR SILK: I think it's a really good point. I think the latest figures show that there's between two and a half to three superannuation accounts for everybody in the workforce and there's plenty of people who only have one account. So there's obviously a large number of people that have got a very significant number of accounts. I think most people acknowledge that consolidation of a larger number of accounts into a smaller number of accounts, possibly one account, is beneficial for individuals. There are some funds, some institutions, that put obstacles in the way of individuals who are seeking to consolidate their superannuation. It can be difficult enough to get the message through to members that they should seek to do it. But when they receive that advice, act on it and then are frustrated from achieving their objective, then it's perhaps not surprising that they give up.

We believe that there should be some system in place that requires organisations to give effect to members' clearly expressed views. There are instances of some organisations that impose excessive exit charges, however characterised, on members who seek to withdraw money to transfer to another account. There are some organisations that refuse to accept a member's request to transfer out of a fund because it's not on one of that organisation's forms, albeit that the member's views are clearly expressed on another document, be it a letter or a form from the fund into which they which to transfer. So those are the two most common hurdles that are placed in the way of people who are seeking to manage their superannuation account or accounts as efficiently as possible and in their own interests. They're both instances of institutions seeking to serve their own interests at the expense of the individual's. To the extent that by way of regulation or legislation those sort of obstacles can be removed and individuals can give effect to their objectives in this regard, that would be a very positive development.

MR FRENEY: That's a not unimportant point for competitive forces in the sense that consumers can actually vote with their feet, and if they're stopped from doing that by some of those practices that you mentioned, then that's not a good thing. But do you think that the industry is making sufficient progress itself in this regard, Ian, or do you think that there could be scope for some kind of regulatory or supervisory front or legislative framework that would help?

MR SILK: I think the industry has made positive steps in this direction. The introduction of what was known as "the transfer protocol" four or five years ago has facilitated members transferring money as they wish. However, there's a considerable number of institutions that don't follow or don't utilise the transfer protocol and do frustrate members' objectives. So in the absence of the industry being able to demonstrate that it can serve members' interests in this particular area, then I think there is scope for some legislative or regulatory regime to enforce appropriate standards.

MR FRENEY: Thank you. I think the other area about which I'd like to ask a question or two might be this one of alternative legislative frameworks, John. We have received submissions that some superannuation providers might find it more efficient and perhaps might pass on costs savings to members of super funds if they could operate under a somewhat legislative framework. They'd be the four profit organisations in particular where they feel that they might be able to operate, for example, under the Managed Investment Act provisions and the Corporations Law and incorporating the elements of SIS that protect the peculiarities of superannuation products into their compliance frameworks for managed funds. So they would actually get efficiencies by being able to in effect combine compliance arrangements for super into their non-super managed fund products. We really haven't heard what costs savings might pass on to the members of the superannuation funds and we haven't really had a significant analysis of the amount of prudent management protection that would be afforded to the fund members. Nevertheless it's an interesting point. I was just wondering how your forum would feel if you got into a world where you might have different legislative frameworks applying to different kinds of superannuation providers.

MR SILK: Our view is that the provisions of SIS of themselves aren't the important thing. It's the effect of those of course and it's the protections that they provide to members. If the protections that are provided under SIS were provided under some other regulatory framework, then that would probably not be of great concern to us. But clearly there's an objective in moving from SIS to the Managed Investments Act or some other legislation and we've seen some of those proposals but, like you, haven't seen the detail of them, and certainly aren't aware in any detail of what the implications of them are. But some of the issues that we would be interested in are what would be the extent of the alleged costs savings and in particular, would they actually flow through to members? Secondly, what elements of SIS would not be transported through to the new legislation and why? Thirdly, in particular, looking at it purely from a member's perspective, what would be the actual impact on the regulatory framework that currently serves to protect the interests of members under SIS? What would replace that on a point-for-point basis as to what's in the SIS legislation under the new legislation?

So to encapsulate that, we don't have a problem per se with alternative legislation being considered but it really must meet a series of pretty rigorous tests principally, seen through the perspective of members, to demonstrate that it's in their interests for that to occur. Again, it's really a question of it may or may not be in the interests of members but if it is being pushed by a service provider it's presumably in the service provider's interest, but that's not the ultimate test. The ultimate test is is it in the interest of members.

MR FRENEY: Thanks very much. My last question is a related one. On page 3 of your submission you say that:

> The IFF can see no benefit in changing the legislation, such that the enabling act is confined to guiding principles for regulators with additional detail contained in regulations.

I think the general insurance draft bill that is now in the parliament is a piece of legislation not unlike this, in that it sets some guiding principles, some important framework sort of issues and then allows the regulators to set standards. Clearly the government has seen advantages in introducing this kind of legislation and some of them can be that it's more flexible, that it responds to industry development, that it allows more competition, it allows more product development, it's not as rigid, the change can be made more quickly as needed. Earlier you pointed to the great need to have a robust protective regulatory framework, legislative framework for superannuation, so I was just wondering in a sense here why you said you couldn't see any benefits in this alternative model like the general insurance draft legislation.

MR SILK: My understanding is that both the government and the industry are supportive of that model, that legislation. Our sector of the superannuation industry is not supportive of that, because the flip side of the advantages you have instanced in respect of regulations as opposed to legislation is the degree of certainty that legislation provides. We start from a position of saying the current legislation provides a good solid member-oriented level of protection and we want that retained, we don't want it compromised and we don't want it put at risk. If we had a different view of legislation, then we might take a different view as to the form of regulatory framework that should occur. But you don't have to be terribly cynical to suggest that if the legislation is sought to be dismantled, such that there's some key principles enshrined in the legislation and the detail in regulations, that the transfer from the existing codified legislation to the regulations can see changes actually occur. There will be pressures from various industry participants for that to occur and we would see that as exposing members to a weakening of what we currently see as a very fine level of protection for members.

MR COSGROVE: Are you also making an implicit more general point therein that whatever the objective of a particular piece of legislation, that you would see problems in additional discretion being provided to the regulator from requirements being set down in legislation?

MR SILK: Generally speaking the answer would be no, because we all know how difficult it can be to change legislation and if every element of a regulatory framework was prescribed in legislation, then it makes it very difficult for the regulator to respond to changing dynamics in the industry and it can be very frustrating for other stakeholders in the industry if the regulator's hands are tied. So we are supportive of regulators having an appropriate level of discretion and a capacity to change their practices as circumstances dictate that that should occur. We would differentiate that pragmatic view of the world with the point that we were just discussing, which really goes to the nature of the overall regulatory framework.

MR COSGROVE: Just one final point, Ian. You mentioned in your opening remarks that you are opposed to a licensing regime. You said it would increase costs and reduce the diversity of trustees. I guess in respect of the latter point, what you had in mind is that some people who are presently playing satisfactorily the role of a trustee might not be able to meet the licensing requirement and so would disappear from the field, so to say. Is that what you have in mind there?

MR SILK: That is certainly a possible outcome. It is also the case that a number of people satisfactorily performing the role of trustees might not put themselves through whatever tests are required to be licensed.

MR COSGROVE: It would be a disincentive for them.

MR SILK: But it also raises the question of what criteria would be used in formulating this licensing system. So there is that fundamental issue which, if a licensing system was to be introduced - and I would repeat that we strongly oppose it - we would have some strong views about what that should and should not entail. Secondly, a licensing system would act as a disincentive for some current trustees to continue in the role. Thirdly, some trustees may well not meet whatever licensing requirements were imposed.

MR COSGROVE: The increase in costs - what would be the effect of the licensing system in that regard?

MR SILK: I don't know who it would - - -

MR COSGROVE: It would depend on the system I guess.

MR SILK: It would depend on the system, but by definition you introduce a system and there has to be costs to it. So there are going to be costs there and those costs will ultimately - perhaps indirectly, but they will ultimately be borne by the members of the funds.

MR COSGROVE: They could be borne by the taxpayer in effect. Well, no, I suppose if the regulator is funded by industry levies, yes, I see what you mean.

MR FRENEY: I suppose it's just worth reflecting for a moment that in terms of licensing, if you are actually looking for higher standards of prudent management, if that's what you are trying to achieve, one way of achieving it would be through licensing. Another way of achieving it could be through the current SIS Act, but actually having some higher hurdles put in, higher entry hurdles put in within the current SIS Act provisions would be another way of achieving I assume the kind of objectives of a licensing regime. It wouldn't be direct alternatives. I think there are different ways of achieving this.

MR SILK: I think you also need to look at why we would be contemplating the introduction of a licensing system. I've not heard any industry discussion and have certainly not heard of any member level discussion indicating that the current capacities of trustees, whether the fund that I'm most intimately involved with or any other, is inadequate in any way. If there was a feeling in the community that the trustee system wasn't operating and that was a reflection of the capacities of individual trustees, then this is an issue we should most definitely be addressing. But in the absence of that on the one hand and a proven track record of the Australian superannuation system powering along pretty successfully, it just seems to me an issue that doesn't need to be dealt with; there is no apparent basis for consideration of it.

MR FRENEY: Thank you.

MR COSGROVE: There is actually one other matter now that we might seek your advice on. It gets back to the area of alternative ways of meeting the objectives of the legislation. What would you think about the idea of incorporating into SIS a capacity for provision of superannuation under a contract arrangement as distinct from under a trustee structure? So as occurs in the case, say, of life insurance at the moment, a fund could contract with a financial corporation to provide a defined or accumulation benefit scheme for its members. This is a question out of the blue, I realise, and you may not have given it any thought at all to date, but do you have any reactions?

MR SILK: My initial and not very considered response would be to - again, looking from a member perspective - seek to establish in my own mind whether the contractual arrangements provide the same level of protection and safeguards for members as the trustee system currently does and that is a pretty substantial onus, and the onus we would submit would fall squarely on the shoulders of those proposing such a move. Obviously in the absence of any detail about what might be in the contract, we would say we wouldn't be in favour of that for the reasons I have just mentioned.

MR COSGROVE: Thank you very much. I am very grateful for your input and look forward to that further detail on the possible marginal improvements that you have promised us and we will break now for lunch and resume at 2 pm. Thank you.

(Luncheon adjournment)

MR COSGROVE: Let's resume our hearings. Our next participant is PricewaterhouseCoopers. Would you each also for our transcript please identify yourselves in the capacity in which you are here today.

MR GAINSFORD: Certainly. Len Gainsford and I'm a partner in the tax and legal services area of PricewaterhouseCoopers.

MS KEATING: Claire Keating, a director of PricewaterhouseCoopers in the assurance and business advisory services area.

MR COSGROVE: Did you want to make some remarks about the submission you have provided to us?

MR GAINSFORD: What we would like to do, if that's okay with you, is just to go through it in two parts. I will just do the up-front bit and talk a bit about the requests and then Claire will go into the detail. We have made some suggestions in the detail about where things might be slightly changed and obviously any questions that you may have at that point. Thank you.

We would like to thank the commissioners because we have had some quite fruitful discussions in the early visits around the time of the issues paper and that was very useful and as a firm we certainly have a commitment to NCP reviews, because we have been involved right from the days with the Wallis inquiry and so on. So this is part of our ongoing involvement and I think that sets it in some context. Firstly, Price Waterhouse has a significant client base in the superannuation and funds management industry. The market may be defined as the market for professional services, and we have looked at your prior reports, one on the architectural profession and we thought that definition was fairly useful. We provide compliance, external audit, internal audit, taxation, actuarial and investment consulting and a wide range of other consulting services to various approved trustees, corporates, the public sector, industry and retail superannuation funds.

PricewaterhouseCoopers is also heavily involved in the industry through its partners and employees participating with industry groups, such as - and we will just name them quickly - the Association of Superannuation Funds of Australia; the Australian Institute of Superannuation Trustees; the Investment Funds Association; the Institute of Actuaries of Australia; the Institute of Chartered Accountants and the Australian Society of Certified Public Accountants. We will provide in the submission obviously some more information about who we are and what we do in appendix 1.

Prior to making the submission, PricewaterhouseCoopers, and this is after our discussions with the commission, ran a number of workshops internally to discuss the issues paper and we had about 20 funds who were our clients and where we have involvement, representing corporate industry, public sector and retail funds. So what we were seeking to do was to have an environment within our own client base, if you like, to put some things to them and come to some views about what we should be suggesting in our submission. We also internally have some views and we will go through that in a moment. So it's on the basis of these workshops and our expert knowledge through our client base that we make this submission.

We have made some requests to the commission in the context of this inquiry and perhaps I could just go through them and then later on we will tag those. Firstly, the six pieces of legislation covered under the reference should be retained with some minor amendments as outlined in the submission. What we are saying is that of course it shouldn't be set in stone, but basically the legislation has been altered and we think at the moment, particularly SIS legislation works reasonably well, but there are some things that do need addressing. The primary objective of SIS must be to continue to provide a strong prudential framework for the superannuation industry and we haven't had an opportunity to read all the submissions. I think we had some difficulty downloading from the Web site but, for instance, I had a look at the Institute of Chartered Accountants submission and there is support there for retention of SIS. There seems to be a little groundswell from what we were hearing this morning with people giving evidence as well.

The commission should recommend greater use of industry consultation and an example we have given there is policy discussions with Treasury to address problems identified in the operation of the legislation, the point being that the legislation is there, there are a set of rules we have heard a lot about this morning, but to make sure that there is proper functioning of those rules, perhaps a consultative process or more open consultative process might assist in the actual achievement of the objectives. That's the way we see it. The third request is that to varying degrees, the six pieces of legislation foster pro-competitive outcomes through business certainty, broad application and availability of the information to industry participants and fund members. We see that as quite a positive thing from the existing - again, focusing mainly on SIS.

Request (d), there should be continued reliance upon audit opinions and advice from entities or individuals who possess the requisite professional qualifications and/or satisfy registration requirements. Just on this point too, we heard this morning - one of our audits is Tower, they mentioned that - we are entirely sympathetic to that process. The shortening of time frames for APRA reporting to four months is making it fairly difficult. There should be a way of addressing that. Tower, I suspect, is not alone, but perhaps we can comment a bit more on that later, Claire.

Our final request is that the commission find that each of the above requests is not inconsistent with the national competition policy. That's the way we read the terms of reference. By that, we mean that we don't think there is a restriction of competition, which is what the commission obviously refers to in its issues paper as flowing from each of these requests that we have made. That is basically all I would like to do and handing over to Claire now on the details.

MS KEATING: I will just give some background in terms of the reasons for our requests. The general consensus both within our office and from the workshops that we held is that SIS generally provides a comprehensive legal framework and prudential framework for managing the interests of members. It provides certainty which is welcome through both the SIS Act and regulations and through the additional guidance which APRA gives through its circulars. That's not to say that we are always in agreement with the circulars, but at least we know what the position is. So that helps in managing compliance costs, because you have more certainty in the way that things will be regulated.

One of the main issues is that employees don't have access to their super for many years and so they expect the system to operate with stability and security. So one of the prime considerations is stability within the industry, and that SIS is viewed in a long-term view, rather than a short-term viewpoint. In terms of costs in complying with SIS, most funds are now comfortable with complying with SIS and there is a general view that even if SIS didn't exist, funds would typically do similar things to satisfy themselves from the prudential point of view. So there definitely are costs, but funds now manage them and are comfortable with them.

The main concern has been the cost of complying with other legislation, for example, administering the surcharge, and any potential costs of having to be licensed under the financial services reform bill. We see SIS as setting a minimum standard of compliance for funds. That is reasonable, given the prudential focus and that there is emphasis on educating members about how their superannuation fund is performing. There has been some discussion about alternative means of achieving the objectives of the legislation. Our view is that the current system works well. We want to emphasise the importance of trustee training and that there is support within the industry for this continuing to occur. There are alternative approaches. At this stage we are not convinced that an alternative approach is desirable.

We are comfortable with the trustee system and it being the appropriate legal structure for super funds and there is the additional level of responsibility, given the fiduciary relationship that applies in relation to trust law. We believe that there is little evidence to suggest that the current trustee system hasn't delivered good results in terms of appropriate investment returns, good service to members and reasonable investment management insurance and administration costs. We believe that whilst there has been failures within the system, these have typically been due to failure to follow the rules of the system, rather than the actual structure of the system itself.

We have noted a number of areas where we believe there are inefficiencies in the SIS Act and we have detailed these within our submission. These are in brief the duplication between the age based limits and the reasonable benefit limits. So there are actually rules in relation to this at both the entry level and the exit level and we wonder whether one rule mightn't achieve the government's objective. There are some very complex rules for employees aged between 65 and 70, some of which were discussed this morning, for example, the trustees needing to know whether members of these ages are working between 10 and 30 hours every week throughout the year.

In relation to overseas visitors, there are rules in relation to preserving the benefits of those within the Australian system. We question the benefit of this, given that as these people leave Australia, it's very hard to keep in contact with them. The benefits typically aren't large benefits and they may not receive that end benefit finally because they can't be found, for example. In-house asset rules is another issue where we think that there are restrictions in relation to the level that investment funds can have in associated entities. These rules seem to be more complex than they need to be.

The risk management statement requirements are very prescriptive and in some cases they add cost for very little benefit. An example of this is funds who don't have a Part B risk management statement have to say that they don't have a Part B risk management statement and then the auditor has to audit to say that the statement that they don't have one was a fair statement. So it's questionable as to what benefit that adds to the process. In relation to key feature statements, we think they are potentially over-prescriptive and could perhaps be simplified.

We also raise an issue in relation to small account balances which is relating to protecting balances below $1000. One of the comments that was made this morning is in relation to the fact that there are probably two to three account balances for every person in the workforce. Each of these account balances may be small balances and may be attracting a subsidy from other members of funds which could be seen as anticompetitive.

The additional issue that we would like to raise is in relation to the deadlines for lodging APRA returns and audit reports, which was discussed this morning. For both small APRA funds that has been reduced from nine months to four months and for non-public offer funds it has been reduced from six months to four months. The problem we are finding with this is that you have only four months in which to get the bulk of the year's work done. There are resource issues at both the administrator level and at the auditor level, which leads to things being done hurriedly, perhaps not in as considered a way as they could be, and we are not sure of the actual benefit of these things being done within four months, when there could be other alternatives such as funds, if it's a revenue issue, paying that revenue within that four-month time frame, or if it's a statistics issue, funds lodging unaudited records that could be used for statistical purposes.

Those are the main areas that I wanted to raise. I guess one of the overriding aspects of our review is in relation to stability and consistency of regulation, so there is certainty within the industry. Thank you.

MR COSGROVE: Thank you. Claire, you said most funds are presently comfortable with the costs of complying with SIS. We have seen a big decline in the number of corporate or employer-sponsored funds, but I take it you would be inclined to attribute that more to factors other than the SIS Act itself, like the tax changes that you referred to. Would that be a fair conclusion?

MS KEATING: Yes. There is some aspects of SIS that cause concern, but - - -

MR COSGROVE: They were the ones I was interested to hear about. What are they?

MS KEATING: Some of the requirements in relation to defined benefit funds which are more prescriptive - I guess again though they are probably due to tax changes such as surcharge which is one of the major issues. I guess there are some rules in relation to funding insolvency certificates for defined benefit funds that are overly prescriptive and there has certainly been a trend away from defined benefit funds for a combination of reasons. But yes, typically it's not SIS that's the issue, it's some of the other legislation.

MR COSGROVE: Another point you mentioned was the failures - I think this is covered on page 10 of your submission. You say:

> Failures have not been due to the structure of the system, but rather to fraud or other inappropriate behaviour.

So you don't think that failures might have been due in any respect to the difficulties that people might experience in complying with the legislation? In other words, does a failure to comply with the act at least to some degree reflect the difficulties of complying with the act?

MS KEATING: I think most funds are trying to comply with the act. Where the failures exist in my experience is where in fact there hasn't been an attempt to comply with the act.

MR COSGROVE: Thanks. I had a few detailed areas of your submission that you might be able to help us on. The first is on page 12 where you talk about the risk management statement requirements and you say there that the requirements of a circular on derivatives could be simplified to reduce the compliance cost. Would you like to give us any advice on what would be a good way to simplifying this area with a view to cutting the cost of compliance?

MS KEATING: One example was the one I mentioned earlier in relation to the need for an audit report on a statement that you don't need a risk management statement. I think that's one easy way. The other aspect is that where a fund outsources its investment management and it has a number of investment managers, each of those investment managers is required to have a risk management statement and that risk management statement is required to be audited. Each fund is required to review that risk management statement and consider whether they accept that risk management statement in terms of actually appointing that manager as being their manager. So the risk management statements are basically the same; the investment manager has one risk management statement which it uses for each of the funds that invest in that investment manager. So there is a degree of duplication in that every single fund is looking at the same risk management statement which has been audited. So is there the potential to place some reliance on the audit that has already occurred?

MR COSGROVE: So the investment manager's risk management statement has been audited by - - -

MS KEATING: Yes.

MR COSGROVE: I see. Okay, thank you. My next question in page 14. Right up there at the top you say:

> The level of industry liaison between fund auditors and APRA has been extensive since SIS was introduced and that has helped to improve compliance and prudential management practices.

There's an unstated implication in that that perhaps more reliance should be placed by APRA on this role played by auditors. Is that reading too much into it?

MS KEATING: That probably is reading a bit too much into it. I guess what we're saying is that APRA holds liaison meetings with auditors at which there is quite a lot of discussion about impending legislation or how current legislation is being regulated by APRA and we've found that extremely useful in understanding what APRA's issues are and, for example, what they see as risk areas and therefore potentially areas where we should focus more of our audit time.

MR COSGROVE: So it's more a question of APRA giving you some guidance on what they see as potential problem areas and then auditors going out into the field and doing their job properly, is it, rather than - - -

MS KEATING: No, there's also, I guess, comment from auditors in terms of where they find legislation potentially unworkable, things where we have difficulty in auditing and the reasons why that might be, so they can take those comments on board and either attempt to change the legislation or to change their interpretation of how they'll regulate that.

MR COSGROVE: Have you had much experience of that latter effect with APRA changing its approach to the implementation of the legislation?

MS KEATING: It's more APRA - there definitely has been. There may be examples where we agree with APRA how they all review our work papers, for example, but often we find that APRA may have their hands tied in terms of what they can actually do in terms of changing the legislation.

MR COSGROVE: So one shouldn't conclude that this process of interaction does indicate some significant problems in terms of compliance with SIS?

MS KEATING: No.

MR COSGROVE: Down at the bottom of that same page you get into the area of the roles and responsibilities of the three regulators and you seem to say there that there's no compelling reason to make any changes to the existing powers and procedures. But then at the top of the next page there's this very interesting suggestion that perhaps we could drop back to two regulators, leaving ASIC out of the picture. How serious is that suggestion? It seemed in a way to be inconsistent with the earlier view at the bottom of the previous page that everything in the garden was pretty good.

MS KEATING: I guess it's referring to the situation where perhaps there is a failure and somebody wants to find someone to blame and they may see what's the clear distinction between ASIC's role and APRA's role and that's more of a public perception than a reality, I think. So what we're saying is perhaps there needs to be some sort of education to the public in terms of where those distinctions lie so that there's more certainty that if something does go wrong, okay, is there actually someone that is responsible for this and who is that party.

MR COSGROVE: So it's not your intention that ASIC have no role in superannuation?

MS KEATING: No.

MR COSGROVE: Okay, simply a clarification of who is responsible for what. There is a point raised in a submission from a participant we will be talking to tomorrow. If I remember, it's Finlaysons, a legal firm. They make the point - submission number 17 if you wanted to look at it in full detail - that the approved auditor requirement or regulation or whatever it is prevents the legal profession from undertaking compliance orders and in their view, this is a sort of restraint of trade. I'm not going to ask you to express a view on the Finlayson point precisely, but is there any obvious reason why compliance as distinct from financial auditing should be preserved to approved auditors?

MS KEATING: I guess the reason that it occurs now is that it's cost-effective and that a number of the provisions that are within the limited compliance audit which is regulated are in fact financial-type provisions. So, for example, "Does the fund borrow?" is something that can be indicated from a financial audit. "Has the fund acquired assets from members?" is again something that we might determine during a financial audit. So in that respect it's cost-effective for the financial auditor to carry out that role in relation to the compliance audit.

MR COSGROVE: What about things like - if I'm on the right track here - "Have the trustees provided adequate information to members?" That kind of requirement doesn't have a particular financial aspect to it - it may, I guess.

MS KEATING: We would audit benefit payments and as part of the benefit/payment audit, we would also look at the statement that was provided to the member. So from that perspective, whilst it's not specifically financially related, we do that at the same time so there is that, I guess, cost-effectiveness.

MR COSGROVE: Are you aware of this type of suggestion being out and about there much or is this sort of - - -

MS KEATING: I am now.

MR COSGROVE: --- coming from left field, as they say?

MS KEATING: It's probably coming from left field. There's nothing to prevent a fund from having a compliance audit done by their legal adviser, but in terms of the audit requirements, we would need to sign off on those limited sections that are with the audit report.

MR COSGROVE: So in effect you would be duplicating the work done by the legal adviser?

MS KEATING: We could potentially rely on the work of that adviser, although again I would question the cost-effectiveness of that because we would need to satisfy ourselves in order to do that.

MR GAINSFORD: Could I perhaps make a general comment as well that the ACCC has looked at our profession and found that it was contestable and if you look at the pressure on audit fees and those sorts of things, there's a fair degree of competitiveness. There are a number of instances outside this industry where people apart from chartered accountants undertake these sorts of functions and it's not a closed shop in that sense. It's just a question of cost, but there is competency and there's a familiarity with certain issues and that's where it's difficult to start from square one sometimes.

MR COSGROVE: But in this case the legislation actually mandates this function being undertaken by an approved auditor. I mean, there's nothing to stop a legal firm from acquiring qualifications as an auditor and playing a role that way.

MR GAINSFORD: I think in reverse it might be a bit hard for us to act as solicitors.

MR COSGROVE: Okay. I think that's about it for me but I'm sure Roger has some other points to raise.

MR FRENEY: Thank you. I might just start in a similar area to the one you started on, John, in terms of the costs of legislation. If I could just refer you towards the bottom of page 7 of your submission, I was interested to note that you said:

> The costs of operating a super fund are significantly less that the costs of providing non-superannuation investment products to people which is germane to some submissions that have been put to us about possible alternative legislative framework such as the Managed Investments Act.

Would you be able to elaborate on this point, that the costs of providing super funds are less than the cost of providing non-super fund products?

MS KEATING: As we note, we haven't had time to do a thorough comparison but we were looking at MERs in terms of, say for example, unit trust products compared to superannuation products and on a very sketchy basis seeing that the typical costs for a super fund were lower than those unit trust products. But we would have to take it on notice if you would like a further comparison.

MR FRENEY: If you had any information that you could share with us it would be very interesting to have that, thank you. Continuing with that same point, you go on to say that**:**

> We are confident that most super fund members receive a better overall return than from a comparable investment product.

I was just interested again in that, whether when you say "a better overall return" you had in mind the tax concessionality giving a better overall return or whether you were abstracting from tax concessionality and looking at the net rate of return.

MS KEATING: Yes, the net rate of return in terms of that the net rate of return includes the cost element and that cost element, we believe, is lower than in similar non-super products.

MR COSGROVE: Abstracting from the tax benefits of superannuation investment.

MS KEATING: Setting aside the tax benefits of superannuation, yes.

MR FRENEY: In terms of the gross rates of return, also abstracting from tax concessionality, did you have any information or anecdotal evidence about that as compared between the two products?

MS KEATING: No, I really don't think it's possible to do that because it will depend on - if you have an identical strategy for a super fund and an investment trust, then they should provide the same gross return before tax.

MR FRENEY: Right. It becomes more a question of the kind of portfolios, the sort of portfolio balance.

MS KEATING: Yes.

MR FRENEY: If I could, I'd just like to move on to your section on my legislation-specific issues and trustee rules and this sort of moves into the area of possible alternative legal structures. You've spoken very strongly about the benefits of the trustee system and of this legislation, but that's part of our job to consider whether the same benefits can be achieved more efficiently. Some other parties have given a submission that suggests that there could be alternative ways, at least for some superannuation providers such as the large funds managers, and one of the suggestions that has come to us is that perhaps the contract based products could be offered more extensively and that you could have a legal framework that accommodated that. I think already some products are available, superannuation products are available, and like superannuation products - I've got in mind RSAs - and some annuity products from life companies. But I'm just wondering in your experience whether you have any views about moving into a system where you might have two different legal frameworks operating for the supply of superannuation products, to give you efficiencies and therefore cost savings to the beneficiaries of these products.

MS KEATING: I guess it's fair to say I haven't considered it in depth, so I'll just make some sort of comment. I guess one of the other distinctions that could be made is between - there's a contractual basis, some sort of basis perhaps under MIA or the SIS provisions, and in all of those cases I guess the paramount thing is retaining protection for the members. I have some concern that if you have a dual structure or even a three-way structure, that each of those pieces of legislation evolves in different ways and leads to inconsistencies in how things are regulated; also, for example, the SIS Act, where you obtain guidance from APRA about their interpretation, would their interpretation differ from other regulators' interpretations and again provide greater uncertainty as to how these things actually should be treated.

The other thing to take into account is how do you actually define what those different sections are? So say, for example, under SIS we might have not for profit or corporate trustees and, say, industry funds. Some of those may be public offer. How do you define between those and a structure that is for profit and is public offer, but, for example, the profit is actually taken by the management of that fund where they have quite high salaries or a bonus system attached to their earnings, compared to a fund where you have executives who are paid, but they are not paid at a for-profit rate? So I think it's going to be quite hard to actually distinguish where do you draw the line between for profit and not for profit.

The other issue I suppose is that the superannuation industry has been subject to a lot of change and continual change will again raise issues of public confidence of lack of confidence. So any change that is made would need to really be shown to demonstrate some benefits to get over that hurdle of increased change and potential for increased public suspicion of the superannuation industry.

MR FRENEY: Thank you very much. They are interesting points. I think we had a participant this morning who was basically saying that to justify change to move towards a system that would allow for example contract law to be used, you would need to demonstrate very clearly some very positive results coming from them to risk any diminution of the protection provisions that SIS provides.

Just moving on a little if I may, Claire, in that same section, at the bottom of page 9 you addressed the question of licensing and you say that you believe there is little evidence to suggest that the current trustee system has not delivered good results and I think you imply, if you don't say, that you are not sure that licensing is required. On the top of page 10, however, you point to a plethora of services that are available. So my question is, could not a licensing regime provide more cost-effectively than SIS the same protective benefits? Could you not through more stringent requirements on licensed trustees have a very strong protective mechanism - preventative very importantly - in place from the word go, rather than having to have such an array of resources under the SIS legislation?

MS KEATING: I guess I would first ask in terms of a licensing regime, are you envisaging that individual directors would be licensed, or that trustee companies would be licensed, or both?

MR FRENEY: I guess it's certainly not for me to interpret, let alone guess what the details of the FSRB might be, or what the regulations flowing from that might be and quite honestly I'm very, very poorly versed in that position to say anything about it. Let's just envisage that it could be either corporate structure being licensed or individual trustees being licensed. I think FSRB envisages or enables both. Let's just assume that.

MS KEATING: I guess - not having considered this in depth, but I will make some comments - there would be a concern, if individual trustees are to be licensed, that that would lead to reduced - trustees who may stand for the member reps, the reducing availability of those because they may not meet those licensing requirements, and in our view, the equal representation rules have actually added benefit to the superannuation system as a whole. From the corporate licensing point of view I guess there would be a question, "Can that corporate trustee outsource that licensing?" in which case, have you actually gained any benefit for the additional cost?

MR FRENEY: Okay, thank you. There are some good points. Perhaps I could just finish please by referring to your conclusion and in fact the very last sentence where you say:

> The strength of the current system is that it provides uniformity to compliance within the superannuation industry.

Would you just like to elaborate on that? Is it your belief that uniformity gives a lowest cost, sort of prudent management framework for member interests?

MS KEATING: Yes, that's certainly our view. The uniformity also provides certainty and so in that respect, providers aren't left guessing in terms of what they need to do to comply and between different providers the product is still provided the same way, like they are regulated in a uniform way so that there's comparability. So I think those aspects give us strength in terms of the uniformity in compliance.

MR FRENEY: Thank you very much.

MR COSGROVE: I have a few others to raise. One is on page 7 where in the middle of that page you're describing or referring to the question of how well the SIS Act accommodates technological and other market-driven changes. I didn't really get, I think, an ultimate answer there. You say that it will be two or three years before, for example, electronic communication becomes the significant source. The question is whether members should receive hard copy information in that situation or whether other electronic means would be sufficient for SIS purposes. Would it be right to say that the act itself is adequate to accommodate increased use of electronic information dissemination and more generally development of new products and so on? Are there any constraints there?

MS KEATING: It's not clear that to satisfy the act, for example, you could provide benefit statements via electronic means. That's not clear from the act in our interpretation.

MR COSGROVE: I see.

MS KEATING: So some clarity on that would probably assist.

MR COSGROVE: In terms of the other aspect of my question, the introduction of innovative, different superannuation products, does the SIS Act contain any impediments there?

MS KEATING: I guess one of the impediments may be a sole-purpose test but I guess there is also guidance in terms of what can be provided and what can't be provided and whether costs can be borne from members' funds or not. So I think there probably is adequate guidance in respect of those types of products.

MR COSGROVE: But you wouldn't say that the act, by virtue of its intended prudential supervision role, unduly constrains funds or investment managers from using new products?

MS KEATING: It certainly doesn't constrain investment managers. It probably does constrain funds, but I guess that gets down to what is the purpose of having a superannuation fund which is retirement benefits, so I think it's probably an appropriate constraint.

MR COSGROVE: Yes, okay. Another one, covering material between pages 10 and 12, are these age based and RBL limits. You seem to say there that there's in effect duplication and that things could be made better. You've made reference to $100,000 individual contribution limit, for example, as one possibility or else eliminate the age based limits because the RBL will do the job for you on the revenue side. Why do you think this still exists? Why hasn't this been rationalised already? Is it the natural caution of revenue collectors or - - -

MS KEATING: I'd have to say I really don't know. Perhaps it is the natural caution. It does seem to us to be a duplication and the reason we have limits - the rules are there for a particular purpose and we think they are suitable to meet that purpose. So the additional requirements seem to us to be a duplication and unnecessary.

MR COSGROVE: Back on compliance costs, page 13, you mentioned that - I'm leaving aside what you have to say about the in-house asset matter because that's outside our terms of reference. But you go on to say that:

> Compliance with the sole-purpose test can offer become difficult and subjective.

I was wondering whether that's a bit of a wrinkle on your general advice to us that the act, given its purposes, doesn't really involve a lot of unnecessary burdens for people complying. But is this one a bit of an exception to that?

MS KEATING: Where it can become difficult and subjective?

MR COSGROVE: Yes.

MS KEATING: I guess we go on to say that the guidance that we get on these sorts of issues provided by APRA is actually quite useful, but there certainly are questions that arise from funds as to, "What can I do?" and "What can't I do?" and funds typically take advice on that before they make any decisions.

MR COSGROVE: That works okay?

MS KEATING: Yes.

MR COSGROVE: You've sort of got a difficulty at the first stage but then after a bit of consultation with the regulator, you can usually find out how to handle the issue?

MS KEATING: Although it may not be as the fund would like it to be; the answer might not be what the fund is looking for.

MR COSGROVE: That's a separate matter. I guess from our point of view we're trying to find instances, if there are any, where the legislation itself is really unnecessarily prescriptive or difficult to understand.

MS KEATING: No, I think it would be very difficult to have something in the legislation to deal with this. The sole-purpose test is not an easy test to apply and if there was something more prescriptive in the legislation, it may actually cause more problems.

MR COSGROVE: Okay. Yes, in the Administration and Enforcement section you say that discretionary powers facilitate compliance. Now, one of the suggestions that's been put to us is that a different type of SIS would be one which had an act with essentially high-level requirements and principles set out in it with a lot of the applications to be left to detailed regulations. How does that type of model strike you? Is that more attractive or less than what we have?

MS KEATING: We actually raised this issue in the workshops that we ran and the consensus was less attractive because one of the features of SIS that funds typically like is the certainty feature and that's what they were concerned about, that they would lose that feature with that type of structure.

MR COSGROVE: So they prefer the requirements to be set down in the legislation?

MS KEATING: There was actually one participant who commented that he preferred SIS to MIA for exactly that reason.

MR COSGROVE: Although we've been talking a great deal about the SIS Act itself, I think you have some small advice for us on the so-called Levy Act. I tend to think of it as the sort of Fraud Act. I mean, you say that establishing a fidelity fund as an alternative, which is one of the things raised in our issues paper, is unwarranted and would make the whole deal more complex. Do you have any thoughts on what sort of criteria might be included in this piece of legislation to determine when such a levy might be triggered or is your view that what's there already is okay from that point of view? It's not a terribly clear piece of legislation I think from that point of view.

MS KEATING: I guess it would be fair to say we haven't concentrated on that aspect and I guess I'd have to take on notice what that criteria would be. We haven't really given it a lot of thought, it would be fair to say.

MR COSGROVE: It hasn't been used but it would be nice to have a well-understood set of principles or criteria which governed its possible and, one hopes, non-use.

MR FRENEY: You have to admit your clients haven't given you cause to focus on this.

MS KEATING: And it certainly wasn't an issue in our workshop that got any time.

MR COSGROVE: Well, I think that's my list.

MR FRENEY: Just one quick question on the complaints processes which you generally support. Some people have raised with us the possibility of people bringing complaints to the tribunal to be required to make a lodgment application fee as a way of providing some sort of sifting process and I think perhaps you mention that - yes, you do mention that yourselves. I suppose one slight variation on that is that the fee could be refundable if it was a complaint that was found to have substance or merit or both.

MS KEATING: Yes, we would be quite comfortable with that approach.

MR FRENEY: That was all, thank you, John.

MR COSGROVE: I'd like to thank you both for bearing with us through these interesting points of discussion and thanks again for the submission and all of your efforts with the workshops.

MR FRENEY: Look forward to the draft report.

MS KEATING: Thank you.

MR COSGROVE: Our next participant is William M. Mercer Pty Ltd. You're here. Please step up to the table.

MR STEVENS: Good afternoon, Ray Stevens and Stephanie Armstrong.

MR COSGROVE: Do you have any capacities within the company which we might be interested to know about?

MR STEVENS: My current capacity is in the Mercer financial planning area but I've been in the organisation and its predecessors for over 30 years now so I'm sort of the old bloke around the place.

MR COSGROVE: And Stephanie?

MS ARMSTRONG: I'm in our research and information area and corporate super, having a background in fund administration in Canada.

MR COSGROVE: We must thank you two for providing us with this interesting written submission. What would you like to tell us about it this afternoon?

MR STEVENS: I'd like to make some opening remarks. We've made a very long submission to you but when you invite us to comment on whether there are any problems with the regulation of superannuation, we could have prepared an even longer submission had we wished. But that doesn't mean that there's not a lot right with the regulation of superannuation. We've come a long way over the last 20 years in particular. It just seems to be a field in which for every three steps we take forward, we tend to take one backwards, and I just wanted to use this opportunity to highlight a few practical examples relating to seven of the issues that we raised, where the point may otherwise be overlooked in the volume of our submission. We'll also of course be happy to address any points that you wish to take up with us.

First, problems with the legislation was one of the issues that was raised in the terms of reference. In our submission we state that our main concern is that the legislation and hence I think the regulators concentrate far too much on minor issues. Perhaps to give two examples, the regulations prescribe the items which must be shown on the annual benefit statement issued to each member of a fund each year and one of these is the amount of the contributions paid during the year by the member. Some years ago the regulator instructed its auditors and fund auditors to have a blitz on non-contributory funds which omitted this item altogether rather than showing "member contribution, zero". That was something we thought wasn't really worthy of the attention that it got.

Another example was to criticise a fund that described an amount as the amount which the member could take in cash on leaving service, and the regulator said that the amount should have been described as the restricted non-preserved benefit because that's the term that's used in the regulations, whereas the fund was trying to use terms which it considered would be better understood and would mean something to the average member and concentrating on the communication, whereas the regulator seemed to be concentrating more on compliance with the legislation. It's that type of thing and I think it's that attitude that needs to be changed.

The trouble is, it seems easier to me to recruit an army of people who can go out and tick and cross boxes and claim that funds are being monitored very closely. It's harder to find people, supervision and audit staff, who can sniff out a potentially serious problem with a fund. We'd like to see some of the - what I call - petty requirements eliminated and see audits spending more time on checking that the claimed assets actually exist and that they're faithful to the nature by which they are described.

Another issue raised was barriers preventing superannuation funds from competing against each other. Our submission considers the situation of a retired person who has, say, three allocated pensions with funds operated by different investment managers, to provide a desirable level of diversification of their investments. Now, if the investment performance or the administrative service of one of these managers is later considered unsatisfactory, it's desirable that the retiree is able to transfer that pension benefit to another manager. But changes that were made to the reasonable benefit limit system in 1994, for unexplained reasons, inhibit that type of transfer.

The benefit was tested against the reasonable benefit limit when it commenced and if it remains in the same fund, it's never tested again. But if you transfer the benefit to another fund, it has to go through a complex set of further reasonable benefit limit procedures and these can result in adverse effects on the tax rebate that was previously available. We consider there shouldn't be any test on the transfer of a benefit to another fund, that retirees should be free to change funds to secure better investment returns or better service, and managers should be free to compete for their business.

MR COSGROVE: Could I just ask on a point of detail there, Ray: that particular case of RBL testing, I imagine that's part of tax legislation, is it, as distinct from the SIS Act itself, or am I wrong on that?

MR STEVENS: It's, yes, primarily in the tax legislation.

MR COSGROVE: Is there an SIS Act angle to it?

MR STEVENS: SIS defines some of the terms; what is a pension, what is an annuity and so on.

MR COSGROVE: But it doesn't prescribe anything in terms of RBL testing?

MR STEVENS: No, it doesn't prescribe; no, it's primarily a tax issue so it may be outside your term - - -

MR COSGROVE: Yes, that's why I was asking.

MR STEVENS: But it's an inhibition on competition, which was what we thought was appropriate to raise.

MR FRENEY: I just wondered if you'd mind if I asked a question because I just thought the previous point you raised was a very, very interesting one and one that really hasn't come up so far in terms of the prudent management of superannuation funds and the protection for member interests. That's probably one I should have thought to ask PricewaterhouseCoopers. But it is this question of verifying the assets and you were pointing to the importance of the regulator's supervisory staff and the focus of their work.

You couldn't think of a more important sort of function for someone to be doing than to be making sure that the alleged assets are there and that they are correctly valued on some realistic market basis. So I was just wondering whether you had any sort of more elaborative comments about that, Ray. Whose job is it? Is it the external auditor's job to check the existence of assets and the valuation of assets? Is that an external auditor's function or not?

MR STEVENS: Yes.

MR FRENEY: It is.

MR STEVENS: But I guess my concern was on what I've seen. It seems to me that the regulator, in looking at what auditors are doing, worries about what's on annual benefits statement - and I'm not saying that's not important - but worries about what I'd call pedantic aspects of that and not enough on reminding auditors, "Are you actually checking the existence of assets?" APRA obviously can't go out and physically check, but they are in turn liaising with the external auditors of the fund. I just think that the attention of external auditors can be diverted from what I think is the most important aspect, some of the funds which have run into some financial trouble. It's often been that an asset described in the accounts as one type of property has turned out to be something quite different to what most of us would have expected it to be, and whether the auditor was aware of that or what, there wasn't enough questioning of that particular classification or description of assets and that they do actually exist and are owned by the fund too, not shown as belonging to the fund, but physically you find somebody else actually has some control over them. I just think there isn't enough encouragement of external auditors to concentrate on that and they get diverted by some of these more pedantic items.

MR FRENEY: Absolutely. Another contributor, I think, used the term "true labelling" and pointed to the Commercial Nominees case where they were describing the kind of funds as an enhanced cash fund, but in fact where you would think the assets would be held in a capital guarantee form, they were in fact invested in mushroom farms and so the members of the superannuation fund were probably seriously misled in terms of the nature of the assets.

MR STEVENS: Yes.

MR FRENEY: But just to turn this back into a question, Ray, are you satisfied that the SIS Act and accounting practices provide adequate legislative protection for members in this regard - sorry, not necessarily regard in the true labelling, but in general regard of asset verification?

MR STEVENS: I think the structure in the legislation is adequate. It's the application of that legislation, that it worries me that we get diverted into minor issues instead of these which I regard as the major issues.

MR FRENEY: Thank you very much.

MR COSGROVE: Sorry, we interrupted your presentation.

MR STEVENS: That's all right. The next point I had noted was conflicts between government departments. Where more than one department or other government entity is involved in the same field, activities are often not well coordinated unless it's a very specific short-term joint project. As an example, the Department of Family and Community Services, APRA and the Tax Office have roles relating to the treatment of annuities and pension payable to retirees and all three sometimes seek the advice of the government actuary on various aspects. Now, complying pensions and annuities are eligible for assets test exemption which is administered by the Department of Family and Community Services and they're also eligible for special RBL treatment which is administered by APRA and the Tax Office.

Those departments have set slightly different requirements for what is a complying pension or annuity, whereas I think we all expected they were going to come up with at least the same set of rules. In addition, where a fund provides a lifetime pension which is not reinsured with a life office, APRA requires the fund to establish a significant reserve in addition to the actuarial value of the pension. This is to ensure that there's a high level of security for the future pension income. But then the Department of Family and Community Services steps in and they often consider that the establishment of this reserve that APRA has required to be set up is a deprivation of assets by the pensioner and accordingly, they reduce or eliminate the person's aged pension entitlement.

This is intended to part of a coordinated government policy to encourage people to take their super benefits as income streams rather than lump sums. But the inconsistent actions of the departments involved has, to my mind, negated much of the effect of that initiative. Now, while this lack of coordination of government departments in addressing superannuation issues is not a new problem, it has, in my view, become worse with the establishment of APRA and ASIC. The objective of this restructure was to have one body regulating similar products, whether provided by a bank, a life office or a superannuation fund or whatever. On the other hand, the purpose of establishing the Insurance and Superannuation Commission some years ago was to have one body regulating nearly all aspects of superannuation funds and coordinating other departments which had to be involved with superannuation.

Under the old structure there was much less conflict between government departments on superannuation matters because one department had the responsibility to sort out those differences, whereas we now seem to have nobody really responsible for sorting out the sort of problems we've had with Department of Family and Community Services, APRA and Tax and so on. Each one just says, "Well, we're looking after our interests and, yes, it may be conflicting with the people across the road but it's nobody's job to do something about it," whereas I think with the old ISC structure, we had somebody we could go to who did try and influence - obviously they couldn't dictate but they tried to use their influence on other departments, but under the APRA structure I think we've lost something in respect of that.

Ironically I think we're finding that APRA is tending to be heading in the direction of setting up specialist superannuation units within the department and to my mind is partly going back towards the old structure. But you have to ask yourself why we have to go through all the turmoil of the restructuring. Problems relating to age and employment, I notice the Price Waterhouse people and others have no doubt raised the same thing. But the classic case of inappropriate regulations which can cause significant compliance costs with no significant benefits to the community is the treatment of persons aged between 65 and 70. Broadly, a person in this age group can only make a voluntary superannuation contribution in a week in which they work at least 10 hours. Then if they have a week in which they don't work at least 10 hours, they must cash their benefit in or convert it to a pension.

Now, APRA expects funds to monitor compliance with these requirements on a monthly basis and many people in this age group work on an irregular basis and these rules result in absurd situations as well as pointless work and costs. Other arms of government tell us it's government policy to encourage those older persons who can do so to work, partly to keep them active and partly to reduce age pension costs. It seems about time we at least extended the contribution restrictions which apply to persons under 65 to apply to persons up to age 70. The restrictions on contributions for persons under age 65 are also, in our view, unnecessarily complex and confusing to many people. For example, consider a person who has not been in the workforce for at least two years. If the person is married, then their spouse can make a contribution to superannuation for the benefit of the person. However, if the person is single, contributions to superannuation can't be made. That's blatant discrimination as well as a policy which has no logical basis. Our preferred position would be to remove all restrictions on who can contribute to superannuation for persons under age 70 and our submission also recommends some relaxation for persons aged 70 and over.

MR FRENEY: Could I ask please, Ray?

MR STEVENS: Yes, certainly.

MR FRENEY: We have had some interesting discussions about this point with Michael Rice - it was with another actuary about ageing population cohorts and the great merits of trying to promote self-funding and I do notice that PricewaterhouseCoopers made a very good point that we didn't actually draw attention to that. A lot of people really don't even have the opportunity to start contributing to super, because of other financial commitments, until they get well into, say, their 40s, and if you're going to try and meet some kind of savings objectives later in your life for retirement income purposes, there doesn't seem to be any particular good reason why you stifle people from trying to do more through their income-earning lives. But I was just wondering, when you say you would favour freeing up restrictions on contributions, would you go so far as to look to break the employment nexus all together? Do you see any reasons in retaining an employment nexus?

MR STEVENS: No, we feel the superannuation system should be there to be used by everybody and there are some people who may never get the opportunity. If you have a person who is disabled from birth, for example, they may never be able to get into the workforce, and some people say, "Well, they wouldn't have any money to contribute to superannuation." But sometimes they inherit money or some of them don't even spend all of their disability support pension and to me, the system should be open to those people even though they're not employed. I think over the years we've been gradually opening it up to wider and wider groups and it's probably just the effect on the revenue of just opening it up in one step. But in recent years we seem to have stopped widening the groups who can contribute to superannuation and we feel it should be open to everybody.

MR FRENEY: I guess it's not our job to really guess what policy ought to be in this respect, but I'd be interested, in your judgment, whether you would get significant efficiencies and cost savings which could flow back to contributors to superannuation funds if you did in fact break the employment nexus. Would it significantly assist in efficiency and cost saving gain?

MR STEVENS: Yes. I couldn't put a figure on the actual cost savings, but I'd have to say in the area I work in now in financial planning, a lot of time is spent in both educating advisers and then advisers then explaining to clients whether they are eligible to contribute or not which all seems to be a little bit pointless. You have situations, for example, of someone losing their partner through death and the surviving partner receives a death benefit and would like to put some of it back into superannuation. Often that's a woman who has not been in the workforce for many years and doesn't want to go and work somewhere for 10 hours a week just to qualify to make a contribution. It seems silly that that person can't, as part of their investments, put some of that money back into superannuation.

The one I mentioned of the spouse contribution rules which were beneficial in some ways - but they did create this highly discriminatory situation where a spouse who has either never been in the workforce or hasn't been in the workforce for years, a contribution can be made for that person by his or her partner, whereas a single person, the superannuation system is closed completely to them unless they have recently been in the workforce. Age 65 has been the sort of age at which certain things happen since, I think, about Federation which is now roughly 100 years ago and we still tend to use age 65 as the dividing age, even though people are living a lot longer than they were when that age was selected. I think it's about time we at least moved it up to 70 for this purpose.

One of the other ironies I've noticed is that about 10 years ago I often wondered if anybody was working beyond age 55 because we seemed in our game to be continually dealing with people who were retiring early and sometimes you wondered whether that was wise, but that was the decision and that was the reality. More recently we seem to be getting a lot more people where the question is, "Do I have to stop working at 65?" or "What should my arrangements be after age 65?" Often, quite appropriately they are not looking to work full-time and regularly. Work is available to them. They're happy to come in and work on a project but they want to take a little bit of time off to do some travel, to do other things and the rules that we've got just don't cope with that sort of system, or you have people going into the financial planner's office and doing some filing for 10 hours just to qualify to be able to make a contribution and that just seems to be an absurd situation. So there is a lot of time spent on trying to advise people whether or not they qualify or what they have to do to qualify where it would be better if that time was spent on working out what they should be investing in.

My next point related to annual returns. For many years the Tax Office has been reluctant to allow balance dates other than 30 June for companies, superannuation funds, trusts and so on and this creates a very uneven workflow for the accounting and auditing professions and for much superannuation administration work. These organisations must either carry more staff than they need for the full year so they can cope with the peak work periods or make extensive use of temporary and often inexperienced staff to cover the uneven flow of work.

The superannuation industry has often advocated the idea that the normal balance date for superannuation funds should be changed to say 31 December. This would produce a much more even workload for the professions involved and for the Tax Office itself. Last year the situation was aggravated because the time allowed to lodge annual returns for many funds was reduced from six months to four months, and there's a tendency for all regulators to keep shortening the period allowed. Whilst shortening the period is desirable from the supervision and perhaps the revenue collection point of view, the authorities should make it easier for the community to comply by moving the normal balance date for superannuation funds and perhaps for other entities, but to my mind, moving superannuation funds to 31 December would move a significant amount of accounting work to a different time of the year.

The Tax Office has often said it's easier when the employer's superannuation fund and the company both balance on 30 June, but we are getting fewer and fewer employer-sponsored funds anyway and I'm not convinced that the problems that they're talking about couldn't be addressed in other ways. It just seemed to me to be a way of evening the work flow in the accounting period.

The provision of information to regulators: as well as providing annual returns to the regulator, selected large funds are required to provide very detailed and complex information on a quarterly basis for the purpose of preparing superannuation statistics. The statistics do not seem to be put to any valuable use and their validity is questionable. This is an unfair burden on the time and costs of those selected funds. We consider adequate and more accurate statistics could be produced from the annual returns submitted by all funds. The current statistics are, by definition, based on sampling and we think sometimes bring out the wrong bias in the statistics that are produced.

The final point I wanted to highlight was preservation. Our submission highlights a number of problems with the detail of the existing preservation requirements and recommends some conclusions. A particular problem is the requirement to preserve very small benefits and the provisions applying to people who come to Australia from overseas to work here for relatively short periods. We kid ourselves that we want corporations to set up their regional headquarters in Australia, but we don't have a satisfactory superannuation environment in two respects: first, these corporations would often like also to set up an Australian superannuation fund to cover all their employees in the region but our absurd rules basically make that impractical. Second, even for those who come to work in Australia itself for a short period, our rules make the provision of superannuation for these people on a practical basis very difficult. These problems arise partly from the preservation requirements and partly because of what is required to have a fund recognised as a resident Australian superannuation fund and we consider that both of those provisions need to be reviewed if we want to become a serious competitor in the region for regional headquarters. That's the end of my prepared comments. We'd be happy to answer questions.

MR COSGROVE: Thanks very much, Ray. They're interesting. We'll be looking at them when the transcript is produced to give them further consideration. I think there are several additional points that I'd like your assistance on. One is a point of clarification; it's on page 4, the penultimate paragraph there, if you have it. You say the increase in legislative requirements in the last 10 years has hit defined benefit funds far harder than accumulation funds, and then new legislation means defined benefits funds are often an afterthought, being required to comply with extremely complex and unsuitable requirements. Is that essentially a reference to the complexities of the tax legislation or is it broader than that? In particular, are there aspects of the SIS Act itself which you had in mind there?

MR STEVENS: The obvious one on the tax side is the superannuation surcharge which was and still is a nightmare for defined benefit funds in particular. Yes, there are some particular requirements which have hit defined benefit funds providing pension benefits. Accumulation funds tend to build up a lump sum benefit and then if the person wants an income, it tends to be taken out of that fund and it goes into an external fund or a different fund. Defined benefit funds - well, many of them years ago of course primarily provided pension benefits, and lump sums only became available on a gradually widening basis. Some of those funds have ceased providing pensions at all because of some of the complexities involved in handling pension benefits.

MR COSGROVE: What is that a function of? What causes those problems and complexities, what piece of legislation?

MR STEVENS: It's a combination with pensions - we have legislation which defines I think now seven types of income stream which can be recognised as pensions provided by superannuation funds and basically you have the complying lifetime pension, which by complying qualifies it for special RBL treatment and social security treatment. You have the complying fixed-term pension which is the newest of those which was added in 1998. You've got the allocated pension. Those ones ironically are not such a problem because you're providing them with a particular purpose. It's when you get outside some of those and you try and comply with the regulations which are intended to cover other types of pension that you find these annoying practical problems coming up; one, for example, which says that you can't increase a pension in any year by more than the average increase in the CPI in the previous three years, so that if you have a pension which you actually want to just increase each year in accordance with the CPI, it follows that in some years you're going to be breaching that regulation, and I suspect a lot do without actually being aware of it. But because the regulation - and this has been raised a number of times - is based in the average over the last three years, it's virtually too prescriptive and too tight. It also implies that unless you get special approval from APRA, that you need to grant pension increases on the anniversary of the date the pension commenced, whereas for most funds it would be easier to increase all pensions on, say, 1 July or some common date.

MR COSGROVE: These are requirements set out in regulations in the SIS Act?

MR STEVENS: In the SIS regulations. Again, it's perhaps close to a tax issue but pensions are harder to handle under the reasonable benefit limit system. There are differences in the way a pension is treated to the way an annuity is treated, for example, and some of these lead to many funds just deciding to keep out of the area altogether. It's too specialised for them. But I think it is just that any change that's made in superannuation tends to be thought of in terms of what does the government want to do in respect of accumulation funds and then they start worrying about, as an afterthought, "How are we going to apply it to defined benefit funds?" and defined benefit funds finish up being regarded as very complex, whereas in essence, the earliest defined benefit funds were much simpler than accumulation funds. People were told, "If you go through to 65, you'll get a pension of 68 per cent of your final salary." You almost didn't need to give them an annual benefits statement because that was there. Now other things have changed. People are not necessarily staying with the one organisation for the same period and defined benefit funds I think are on the way out because of their lack of flexibility, but nevertheless they did serve a very good purpose and have just become more complex to run.

The superannuation guarantee is another area. With the superannuation guarantee, you've got the legislation prescribing a minimum contribution of, say, 8 per cent of some earnings base. When you come to apply that to a defined benefit fund where, by definition, contributions are not allocated between members, it had to be handled in another way and we finished up with this benefit certificate that the actuary provides about every three years where you specify a minimum benefit that has to be provided. But to work out that minimum benefit, most funds actually keep a notional accumulation going to say what would have been accumulated had we been operating as an accumulation fund, so you finish up with trustees saying, "We have to keep an accumulation record anyway, why do we also have this defined benefit? Maybe we'll think about getting rid of it." So you've had - - -

MR COSGROVE: A combination of factors.

MR STEVENS: - - - a combination of factors that's caused defined benefits to decline.

MR FRENEY: Can I just ask while we are on that point, is there any sort of stand-out, more efficient way of approaching this question of pension calculations that could be incorporated into SIS, Ray, that would lead to efficiency gains?

MR STEVENS: I think we've got to have some minimum pension standards in the regulations and mainly minor modifications would do the job. I think the ISC at one stage actually had a review of the requirements but nothing basically ever came of sorting out things in the initial regulations which were difficult to interpret. I mean, the little thing I mentioned about the consumer price index thing, it wouldn't be hard to draft regulations which approve what everybody would accept is a normal practice that would be - you know, if it talked more about increasing pensions in line with CPI changes rather than trying to prescribe the date on which you have to give the increase and whether you can average over three years or what, I think you could have much more relaxed requirements which still expressed the principle. But you do have to be careful of the small industry which is out there and exploiting these provisions if they can. I saw one strategy the other day, for example, which involved somebody setting up one of these pensions in a self-managed fund, of course, purchasing it for, say, $500,000 and then the next day commuting it for a hundred dollars and this achieved certain objectives, so you've really got to have some restrictions which tend to tackle that sort of thing. Ironically, the current quite restrictive things often don't tackle that type of thing anyway. In other words, they're on the wrong tram. So you do have to have some requirements but the existing ones are certainly in need of a review. They were fixed some years ago in good faith, but as time has gone by, the problems with those are little problems that have shown up.

MR COSGROVE: On page 8 you address the question of, "Are there less costly ways of achieving the legislation's objectives?" With a view to avoiding incessant change, you favour an approach whereby you keep the current system but you try to simplify and improve parts of it that are causing significant inefficiencies. Would it be fair to say, Ray, that your definition of those parts is pretty much covered by the material in the appendix?

MR STEVENS: Yes.

MR FRENEY: Could I ask please while on that page, in the previous paragraph you say that in your view, less prescriptive legislation focusing more on its intended outcomes and less on the means of achieving them may be one way of providing less costly legislation. You went on to talk then about the need for consistency in application by the regulators. I was wondering whether you actually had a preferred model superior to SIS in mind when you were writing that?

MR STEVENS: No, we would not favour a wholesale replacement of SIS. I think it's more evolution if you like, just modification in some areas. Even the example I used on contributions, I think some things have been achieved. The example I quoted about requiring you to show on the benefit statement the amount attributed by the member and then worrying about if it was nil, did that mean you have to show member contributions nil - that was a specific requirement under the original OSSA regulations when the SIS regulations were drafted, because we had the opportunity of raising this point. They finished up moving in a direction which was actually suggested by some of us that the regulations should be more along the lines that the benefit statement should show the information that the member needed to know to understand benefits. Then it referred to particular items needing to be shown where they were applicable and you can have some argument about whether a thing is applicable, but clearly in a case like the member contribution, you could argue that if there were no member contributions made to that fund, then obviously it was not applicable and you could leave it out, so there was a bit more flexibility.

The only trouble was the list of suggested things that got on this list kept getting added to as time went on. But just the way in which the regulation was framed was less of creating a box-ticking situation; it was more saying that your benefit statement's main objective was to explain the benefits that the member needed to know about.

MR COSGROVE: Or, for example, your other example of having the auditors focusing on the existence or otherwise of realistically valued assets as compared with - - -

MR STEVENS: Exactly, and whether you use the same wording as the legislation used, those sorts of issues. Whereas if the regulation is more expressed in terms of its purpose rather than getting to prescriptive - - -

MR COSGROVE: And the processes, yes, I see. Thank you. On the next page you refer to the financial sector of the reform bill likely to require greater licensing and then you go on and say:

> It's clear that many existing trustees will never be able to attain the qualifications needed to become licensed, so there will be a lot more outsourcing.

Why do you think that will be the case? Do you envisage fairly strict licensing requirements that will debar many employee representative trustees, for example?

MR STEVENS: I guess, first of all, as you are aware, CLERP 6, as I think it's called, has been through a chequered history in getting to the stage of is it going ahead or isn't it or in what form, but as I understand it, despite a lot of objection from the superannuation industry, it is proposed that trustees or superannuation funds perhaps other than self-managed funds will need to be licensed. I think one of the good things that occurred in recent years was equal representation and the fact that we had company funds where half the trustees were people elected from the shop floor, if you like. I think that did tremendous good for spreading the acceptance and knowledge of superannuation and you had people who were not necessarily people with great financial skills.

My early days in superannuation when you were looking for who should be the trustees of the super fund tended to be the finance director and a couple of other senior people - I don't think so deliberately to keep management as such in control, but more because it was seen to be a financial operation. When you brought in these people and you had these people discussing the distribution of a death benefit and so on, these were down-to-earth people with a different set of experiences and outlooks; I always likened it to a jury, that you don't have to be a lawyer to be on the jury. In fact I think it's the other way around; if you are lawyer, you get excused. I think it was great to get these people involved in superannuation. As time has gone by I understand a lot of funds are having trouble getting people to nominate for appointment and I just feel the requirement that they be licensed, almost regardless of what the requirements are, will frighten those people off.

MR COSGROVE: So you see it as more of a deterrent than, if you like, a disqualification of potential applicants.

MR STEVENS: Yes, we haven't specifically seen what being licensed will actually mean, but my fear is it will be something that will first of all, yes, deter people and may even require that they show certain knowledge which will virtually disqualify the sort of people that we need on those trustee boards.

MR COSGROVE: Is it that group really that you have in mind, the employee representative trustees?

MR STEVENS: Yes. I guess this is going by the thrust of some of the consultation on CLERP 6 and I think the people designing it tend to be thinking more of the financial needs and think of trustees as managing the investments of the fund, which is fair enough in its own way, but forgetting that part of their other function is to supervise all aspects of the management of the fund and its explanation to members and there is a place in that group for people who are not necessarily so-called financial people, but people who understand human relations and other issues. As I say, I've heard particular management people say that in issues such as even consideration of disability claims, you have had people who for years have complained that the trustees didn't seem to be doing it and when they have actually been there and had to make some of the decisions themselves, some of them become some of the greatest supporters in handling people outside and saying, "You don't know what it's like when you actually have to sit there and take part in the decision-making process yourself." I think it would be a shame to virtually force that to go. I know there is probably less equal representation now, because we are getting fewer and fewer corporate funds, but it doesn't mean that I wouldn't like to see the whole concept go out.

MR FRENEY: Could I ask a supplementary on that please. You could envisage that with a licensing regime requiring higher standards than now, you would have perhaps a higher cost structure for the trustee entity. For example, employee representatives might be paid to be a trustee member and for that you would expect a higher standard of benefits in the form of higher prudent management of the superannuation funds, which is what SIS is trying to achieve. You might say it's in the community interest and the interest of the members of the super fund to have even higher prudent management standards. The risk of that I suppose is that you might tend to force the closure of more employer-sponsored funds and get a stronger drift of funds into the so-called for-profit sector. Would you see any problems from a sort of competition policy point of view if you had that outworking of a higher prudent management scenario?

MR STEVENS: Your remarks - and I am not criticising you for this - tend to assume that if you have a group of trustees who are more the finance director and so on, that the investment side of the fund will be better looked after. I am not sure that's always the case. I have heard people talking to a group of trustees where you have people from the factory floor who can often ask the investment adviser some much more basic questions that the others tend to take for granted about, "Should we really be going into mushroom farms?"

I don't think that if you have a board of, say, six trustees, that just because you may have two who don't have a strong finance background, for example, that you are jeopardising the security, by replacing them with people with more financial experience, that you would necessarily increase the security of assets. The trustees are there as an overviewing body. You still have the people administering the fund, the investment managers, the external auditors and others who should be looking after these security aspects and these people are more sniffing out that maybe something isn't being looked after properly, and I don't know that it necessarily has to be people with a financial background solely who do that work.

But I can see that there is an argument that if you don't require licensing of these people, if you leave things as they are, maybe the security of investments is not being examined in the depth that it should. I guess I'm saying that's not the sole operation of the trustees. They also have responsibilities for the distribution of death benefits, the explanation of things, the other aspects of the fund and it would be a shame to see that role disappear. I think as you said, the end result would probably be to increase the closure of corporate funds and make it a much more professional operation.

MR FRENEY: Would you see that as a bad thing, Ray, if there were - - -

MR STEVENS: I think it is a shame in that I think that - I mean, to some extent we can't really turn the clock back. We have already gone a long way in that direction, but I've seen that companies and their employees who sort of regarded the fund as their own and then as it's come - even where people like ourselves come in and take over more and more of the administration, at the end of the day they say, "This isn't really an ABC fund, it's a Mercer fund," and they don't sort of see it as their own. So we have already gone a long way down that route and I personally think it's a pity. On the other hand, yes, I think years ago some of the administration - and by "amateurs", I don't mean criminal, I just mean the incompetent amateur administration, probably were too much the other way and you had companies which regarded the fund as their own and we invested as we liked and a lot of that might be investment in the company itself, for example.

MR COSGROVE: At the top of page 12 in your submission, Ray, you are talking there about regulatory overlap and we have heard different variations on this theme. You were saying that it's not always clear to the industry where the boundaries between the regulators' roles lie and you can get conflicting responses from different regulators at a cost.

> These issues generally relate to overly complex or unclear aspects of the legislation.

Could you give us a few examples of those areas of the legislation?

MR STEVENS: One we've already talked about is the administration of pension benefits, where you have different objectives from the different departments. There are some areas where actuaries are involved where we're not clear whether we're doing something for APRA or for the Tax Office or whether their requirements are identical. At one stage the actuarial valuation for a defined benefit fund was typically done every three years and there was a fairly well-established pattern as to what you were expected to look at. Now we have some APRA provisions implying that you need to do valuations annually unless you get approval for less frequent valuations.

MR COSGROVE: Are these sorts of problems in the nature of irritants or are they more significant than that?

MR STEVENS: Yes, most of them are irritants and in some cases they do go a little but further than that. I mean, it's perhaps a little bit of each but the one mentioned before about the complying pension, the requirements of Department and Family and Community Services, finishing up slightly different to those in the reasonable benefit limit legislation, means you can't just provide in your rules for a pension payable on terms which comply. You either try and have one with provisions which are wide enough to meet either of the requirements, whereas if there was one definition in the legislation of what is a complying income stream, you could provide that in your fund rules and that would be the end of the story.

We set out on page 20 - again this is in respect of pensions - that there can be potentially six different values placed on a pension for a variety of purposes and each one is a different purpose, but it's (a) costly and confusing for the client. It may be fine for actuaries in some ways, although it's no pleasure defining these things, and of course they can be in conflict, and I'm sure it could be better coordinated.

MR COSGROVE: Okay. I think my remaining question is a sort of a broader one. You've mentioned that you don't think there's a strong case for, if you like, wholesale to the existing legislation, rather to work incrementally to tidy it up in some respects. However, we are under our terms of reference required to satisfy ourselves that there are no better alternative means available to achieve the objectives of the act and one possibility that's been raised with us is, if you like, a dual system where you would have for-profit superannuation funds shifted over to the Managed Investments Act, where many of the providers of them find themselves already having to comply with that act, and the not-for-profits remaining under SIS. From your perspectives at Mercers, which are pretty widespread, do you have any thoughts about that type of arrangement?

MR STEVENS: We wouldn't be enthusiastic. It perhaps brings us back to the basic issue of should the trust structure be used.

MR COSGROVE: Indeed, yes.

MR STEVENS: I think the trust structure has served superannuation well for many years, and of course trust legislation in general has been developed over hundreds of years in many ways and it involves to tackle new approaches, and I think it's still one of the best structures. I certainly wouldn't like to see abolition of the trust structure. The idea that, yes, some funds could be established under a different structure I don't have quite the same problem with.

MR COSGROVE: Provided they maintained a trust arrangement. Is that - - -

MR STEVENS: It was very similar to that because I think in the previous discussion we mentioned RSAs, which were I think a move away from the trust structure, but what we finished up with there as I understand it is that the operators of RSAs can only provide a capital guarantee type of investment. In other words, it's a very narrow investment, and one of the beauties of the trust is that you have a separate portfolio of assets backing the liabilities of that trust regardless of who manages it.

Going way back to 1983 when an animal called an approved deposit fund was invented, I think it annoyed at the time some of the banks and life offices that to operate an approved deposit fund, you had to actually have a freestanding portfolio of investments by that fund. So maybe the real motive there was it was quite clear that those were the assets that would be taxed in the manner applicable to superannuation, but it also made it quite clear that those assets were separate from the other operations at the bank or life office or whoever it might be, and I think it worked very well.

I don't think anybody has come up with a structure - as I say, the RSA doesn't go as far as allowing a wide variety of share investments and so on because it's hard to get the security aspects right, the tax aspects right, the equity aspects in distributing investment income. So I would not be opposed to - provided one didn't insist on trusts changing to a new structure, if there were a separate structure that could be used by some of the other institutions who handle other investments. I'm not sure whether the managed investment structure would work. If it still required freestanding investments to be backing it, it's really still very similar to a trust anyway, and these organisations I think overcome some of the administrative problems by the way in which that trust is invested. There's nothing to stop the trust investing in the units of another trust which may in fact be the same pool as is used by the non-superannuation managed funds; you just hold the units and the trust itself is taxed in a different way.

So, as I say, I wouldn't be opposed to having an option to trusts provided you can still continue to use trusts. I think the last thing we want is another major upheaval like we had when SIS was introduced, where there were many thousands of dollars and many thousands of hours spent on revising trust deeds. A lot of the issue was to come up with a structure whereby the federal government felt it could use the corporation's power to control trustees and so on. It was important that the actual fund member didn't really see any benefit from all of this and the last thing we want is another paper war where we have to basically go through and do a complete restructure.

But as I say, if it's a thing whereby organisations like banks and insurance companies could operate without having to set up the trust structure, then that would perhaps be all right. We have something along that line at the moment with annuity contracts, where they are not run through a trust structure. You can have people who collect their retirement benefit and can use it to take out an annuity contract so that it's still part of the superannuation system as such but it's not part of a trust, as I understand it, in a normal way, if it's going in that sort of direction. Of course those, particularly allocated annuities, for example, do allow a wide range of investments but somebody would have to come forward with a suggested structure that would actually work.

MR COSGROVE: If you could, would you envisage significant cost savings for members of funds as a result of a large financial institution no longer having to operate through a trust arrangement?

MR STEVENS: No, because my understanding is most of them - it's only almost an extra piece of paper that, if you want to invest in superannuation with - I'm not sure if all the life offices work in this way, but with one life office you simply sign an application as you would to join a fund and that application is addressed to the trustee. This trustee in fact invests all the assets of that fund with the life office, so that you've only got an interposed trust entity before the money actually does get amalgamated with all of the life office's other operations. I'm not sure that by abolishing that, so that you just apply direct to the life office, it would really make that much difference once the initial structure has been set up. But I guess the life offices and the banks would be better able to comment on the costs involved.

MR FRENEY: In this very area - I find it an interesting one - Phillips Fox's consulting actuaries made this point to us that perhaps there should be more allowance for superannuation contracts to be written under contract law and not to impose trust structures on I think the likes of life insurance companies where they are prudentially supervised. I just wish I understood a little bit better what the risks might be. I understand what a good job the trust structure does in protecting the interests of the party taking out the superannuation product but would you be able to elaborate for me or elucidate if there are alleged benefits in not having to have a trust structure - and presumably those benefits might get passed back to the member of the super fund or the individual coming off the street. Are you aware, Ray, whether there's any sort of higher risk to that party by not doing it through a trust structure?

MR STEVENS: I think there could be without saying this is a completely thought-through process but I think what the institutions would be looking for was to avoid the need to actually have a separate portfolio of investments as such. In other words, the superannuation fund investments would just be mixed in with all the other investments or most of the other investments of the institution. Now, that could weaken security. On the other hand, I suppose it could strengthen it because it could be part of a larger pool of investments. But you have issues - and this came up with the approved deposit funds when they were established - that we have a principle in superannuation that we don't allow superannuation funds to gear their investments. They're not allowed to borrow for those purposes.

If you've mixed the investments in with, say, a bank's operations, you've got loans being made as part of the normal business in other parts, and how do you keep all that separate? The trust structure does at least ensure that you can impose the same sorts of controls that you think are desirable for superannuation funds operating through trusts. You can impose those same limitations on them. Once you start mixing it with the other assets of the institution, I think there is some scope for weakening the security.

MR COSGROVE: Does the essentially long-term nature of superannuation whereby a person might be contributing over 30 or 40 years involve some additional element of risk under a contract structure? I mean, how reliable would a contract be over a long period of time. I guess it depends on the strength of the provider, the other party to the contract really. It may be quite okay in some cases, and maybe not in others.

MR STEVENS: The hard part, I think, in thinking about this is we're thinking of the people wanting this as being the Westpac, the AMP-type organisation, but once you approve that structure, it's a little bit like the development of self-managed funds. I don't think anybody envisaged the extent to which people would be starting to run their own fund and saying, "Well, if the big funds can do this, why can't we?" and we try and limit the differences between these. Having approved a structure that you think is fine for these large institutions, or you hope it's fine, then how do you stop the relatively small organisation where you may not be quite so happy to see them mixing this business with some other business and not having a clear distinction, and that's one of the things that worries me with it. Unless you move more to like what we have with an approved trustee, where the nature of that almost limits that sort of operation to the larger providers - and in any event they have to be individually approved - or would you be trying to set up a structure where anybody operating any sort of institute could choose to either go the trust route or go by this alternative, or would they have to apply and virtually get specific approval, just like getting a licence to operate a life office, a bank licence.

MR COSGROVE: Like a bank licence.

MR STEVENS: A bank licence. I just did not fully - - -

MR FRENEY: Actually Phillips Fox sort of acknowledged that point and went on to say in their submission that you might get some smaller superannuation providers who were not the very largest institutions, and that you then might have to think of some different solvency and capital adequacy requirements for those smaller ones if you're wanting to issue super products under a contract arrangement, if they were going to issue super products under a contract arrangement. So it certainly gets more complicated, and the question is, what are the benefits from it?

MR STEVENS: Even the equitable aspect of how do you share the administration expenses, for example, there are of course some practical problems now, but I think where you have a separate trust, it is easier for an organisation to more closely identify the costs associated with that. I think with the Price Waterhouse people you were talking about the relative costs of operating a managed investment non-superannuation arrangement and a superannuation arrangement, and it occurred to me that superannuation funds - I would expect the costs to be lower. If you're operating, for example, a unit trust open to the general public, with a superannuation fund you're mainly accepting contributions and typically benefits can't be taken out until some time down the track, whereas with a unit trust, people can put money in and they can be - you've got to provide for people withdrawing money, putting money back in; you've got more transactions. Once a year you've got to give those unit trust holders details of what amounts they have to include in their annual tax returns, whereas with your superannuation fund, it's the fund as an entity that handles the tax side. Then, okay, they've got to distribute the tax load equitably among their members, but the members don't get directly involved in that. Therefore it doesn't surprise me that superannuation funds are cheaper to operate in that sense than managed funds, and if you've got the same organisation offering these things side by side, they have some problems now in allocating expenses, but if the thing is more mixed up in the one unit, you're far more dependent on their systems - well, it would be harder to prove they're not being fair.

MR FRENEY: It may also be perhaps in the long drawdown period of some superannuation products, like John was talking about the long contributory phase, I'm just wondering if it could also be something to do with the long drawdown period that if, for example, a life company was wanting to offer sort of superannuation products under contract directly into a statutory fund rather than through, say, a trust vehicle, whether extra complexities come in because of the lengthy drawdown period of super and the taxation preservation sort of requirements around it that would make it much more complicated to have it directly in a statutory fund than through a trust structure. I just don't know, but I'm trying to think of what the reasons might be for, the difficulties that might be associated with this.

MR STEVENS: I'm not as familiar with exactly how the life offices work these days, but we used to have the issues of allocating amounts between superannuation business and ordinary business. These days I think most of them tend to have the superannuation in a separate statutory fund.

MR FRENEY: Statutory fund, right.

MR STEVENS: Therefore security issues and so on are - it is almost like having a separate trust.

MR FRENEY: Yes, that's true.

MR STEVENS: It's just not called a trust. It's governed by a different vehicle. I don't have a problem with that, but concerned if you then allowed virtually organisations of any size to start doing this, you'll get people who will choose to use these things for the wrong reasons.

MR FRENEY: Yes.

MR COSGROVE: Well, thank you very much. I don't have any further questions now, thank you.

MR STEVENS: Okay, well, thank you.

MR COSGROVE: Thanks very much for coming along and for a very useful submission.

MR STEVENS: Thank you very much.

MR COSGROVE: We'll take a break now before we meet our next participant.

MR COSGROVE: Our final participant for this afternoon is Jacques Martin Industry Funds Administration and Fiona, would you just for the purpose of our transcript identify yourself and the capacity in which you are here today.

MS GALBRAITH: My name is Fiona Galbraith and I am manager of compliance for JMFA, the shorthand version.

MR COSGROVE: Thank you. We are very grateful to you as we were saying for your late-night efforts to get this submission to us. I am afraid although we have had a chance to read it rather hurriedly, we have not yet been able to get right across it, but we have some points we would like to raise with you. Would you like to make any points yourself at the outset or not?

MS GALBRAITH: I suppose just to say a very brief opening statement.

MR COSGROVE: Yes, sure.

MS GALBRAITH: We strongly support the retention of the trust structure in superannuation, given the nature of superannuation as a financial product, the fact that it's long term, but even more significantly government mandated contributions going into - and also it has been acknowledged now by the courts that it really is in fact a deferred wage and salary. So it's people's entitlements and earnings going into super. Given that, we think that the protection afforded by the trust structure by the fact that the trustee owes fiduciary duties to the beneficiaries or the members of the super fund is a quite significant protection that shouldn't be eroded lightly. I suppose that is the most fundamental thing.

As a second tier one, we also support strongly the existence of super-specific legislation. While we acknowledge that the Financial Sector Reform Bill is moving towards uniformity of regulation within the financial sector, I suppose we are of the belief that different products exist for different reasons and to satisfy different needs. While the theory may be that a person is sitting back with discretionary income, choosing between a general insurance policy or a life insurance policy or to put some more super in, in reality they are choosing those financial products to meet very specific needs. Each of those products has different features, because they are meeting different objectives. So they have different features. There are risk products, base products, investment return products. They are different and therefore for ease of compliance it is much easier to deal with legislation specifically drafted with your particular products and your particular financial product in mind, because the major difficulty in compliance is interpretation and application.

Even if the policy is well conceived, and that is tricky in itself, applying it across different products and well drafted, applying it to your particular product can be where some of the problems lie. So when you get into generic language, it starts a whole round of - in the end there end up being circulars and policy statements and all sorts of different things basically doing the application of the generic legislation to the specific products anyway. So by the time you have gone through that, you may as well have specific legislation. I suppose they are probably the two major issues that we see.

MR COSGROVE: Do you have any general thoughts, Roger, or should we just work our way through the submission section by section? I think I'm in the latter category.

MR FRENEY: I think so, yes, but we may come back to this interesting second point that Fiona was making and perhaps work our way into that.

MR COSGROVE: I think my first question arises on page 2. Up the top there, Fiona, you say the legislation is not overly prescriptive with a few possible exceptions and within the bounds of policy it does tend to accommodate changes in product design. Could you give us a few examples of areas in which that has occurred, these changes in product design?

MS GALBRAITH: It's probably easier to give examples of the negative to start with, which is I guess that there are superannuation providers out there who feel that they are constrained by the sole-purpose test and that is very much a policy issue. That's really what I was thinking of when I said this. That's very much a policy issue as opposed to anything to do with the drafting of the legislation, prescriptive or otherwise. I guess that probably is perceived as being the major constraint on product development.

Having said that, within the fundamental constraints of the legislation as it is currently conceived, conceptually and drafted, I think there has been a fair bit of innovation out there. I think most funds are always looking - are competitive in the market - for a point differentiation. I think that is happening. I guess the other area where there are some issues are probably insurance, the extent to which various insurance products can be offered through super funds. This comes down to really fundamental retirement income policy and if you believe that these contributions are basically being invested prudentially, using the man on the (indistinct) looking at risk and return and maximising people's retirement income in retirement and that I suppose is kind of what the whole purpose is driving at.

Then I suppose it's an interesting question as to the extent to which there should be product enhancements and developments going on, whether they are at the end of the day more market driven to the detriment of retirement income policies and that is much more of a fundamental policy issue than it is a legislative drafting one.

MR FRENEY: I notice, Fiona, that you say that one of the costs of compliance is complying with specifications for reporting to government.

MS GALBRAITH: Yes, that really was more of a tax focus probably than - - -

MR FRENEY: I was wanting to ask whether sort of under SIS you have the unnecessary reporting requirements. Some other contributors have suggested to us that there are unnecessary reporting requirements. For example, they query the merit of the statistical collections and I was just wondering whether you had in mind any specific examples of unnecessary government reporting requirements. I think you actually might come back to this later on, so I am sorry if I am pre-empting something you say later on.

MS GALBRAITH: It's actually my fault, because I must admit I was thinking of - when I think specs, I think of all the tax reporting we do. In the context of the question you were asking, I guess for us we certainly feel that the annual reporting should be occurring to APRA in particular as part of the prudential review. The statistics don't pose us an issue, because our trustees are very geared on - they really want to know about the statistics of their fund and we are a very large volume fund, so we have systems that not exactly produce statistics at the press of a button, but not far off it. So for us it's not an issue and we think it's worthwhile for the regulator to have a feeling for the demographics of the industry that they are regulating. But I imagine maybe for some of the smaller funds, manually compiling the statistics may be an issue. I'm not sure where the cut-off is targeted for statistics. I believe it has moved to the ABS, has it, away from APRA - I'm not sure - and it used to be funds of a certain size or a certain number funds and it might be the - it still is APRA?

MR FRENEY: I think the principal collection agency seems to have reverted to APRA. It certainly has been boosting up its statistical unit and from what they told us, I had a feeling that they were now becoming the principal collector, which interested me.

MS GALBRAITH: It used to be - probably everything old is new again - it probably went to ABS and came back. I guess wherever the end of their sort of collection pool, that is probably the edge which is having some issues. Certainly for our funds I don't think it's a major issue. It is really more or probably the Tax Office and when they changed their specs without warning, which they have done a couple of times, then that causes enormous headaches. But that is outside the scope of your review.

MR FRENEY: The other point I had on this page was your reference to the definition of "successor fund" which other participants have raised with us. It seems to me as though the intention here is right minded in terms of trying to get an efficient vehicle for allowing the transfer of funds, but the problem is in the detail as in the writing up of the descriptions as to what a successor fund is, so you protect member interests well enough on the one hand, but get clarity in the provisions on the other. That seems to be the main problem of getting this clear definition written into the law.

MS GALBRAITH: Yes, you are right. The policy intent was to facilitate the winding up and merging of funds and that is certainly a good policy. It all comes down to the phrase and it's two words "equivalent rights" and there has been a lot of legal advice and opinions going around a number of funds that sought it and widely diverging legal opinions I might add, because it is a two-word phrase and there has been a lot of involvement with our people producing a recent circular. It is an interesting point, because I think from my perspective it illustrates the strength of trust law. That is one area where I would like to see it not prescribed in the legislation and basically to fall back on the trustees of the first fund, the fund that's doing the transferring out. The fact that they owe fiduciary duties to their members should be paramount and they have to act in the best interests of members and really, that's the fundamental question under trust law that they should be addressing.

The consideration they should be asking themselves is whether it's in the interests of members to transfer across to the other fund. There has always been speculation whether what was intended was as little as basically moving across the quantum and accrued benefit, and it's "How long is a piece of string?" There is a whole spectrum of various things that could be considered to be equivalent rights. There has been a fair bit of resources tied up in it and I suppose that is the one thing I perceive as a barrier to exit for funds, because there is an awful lot of toing and froing and trying to establish exactly what equivalent rights is and you will still get differing opinions on whether you can, for example, go from defined benefit to defined contribution or not, those kind of issues. So I am not sure what the solution is, whether to remove it from the legislation and leave it to trust law to determine - I mean, the circular has probably gone a fair way towards it, but I know there is still some controversy out there.

MR COSGROVE: You suggested that a revisit of the underlying policy considerations may be warranted.

MS GALBRAITH: Yes.

MR COSGROVE: By that did you mean like reliance on the trust law as you were saying, or did you have something else in mind?

MS GALBRAITH: I suppose just more specifically what I was just alluding to, whether whoever dreamed up the concept of equivalent rights - just want they meant by that. So whether they meant equivalent right to the amount of money that had been accrued, whether they actually meant equivalent insurance, equivalent right to surplus, whatever the issues were, just what the policy intent was behind - it's actually in the regs, yes - and just have a look at that because that was something that was a bit unclear. I think the ISFA's thinking was - I don't know what it was like at the time, but APRA's thinking in recent times has been a bit unclear, depending on who you speak to, because it is a very tricky area and there has been analysis done and I think Pamela McAllister from Freehills did an analysis one time and there are about five different tiers of rights within trust law. She thinks - from memory - about tier 3 of 5 is probably where it should be. It probably needs some trust lawyers to really analyse some of the trust law and establish how far it extends and really clarify that. I know that one has just come out, but I think there are still some issues within that. Having said that, it's not something where I have actually had direct involvement. I mean, trustees of our funds sort it out with the trustees of other funds. We are just doing the administration.

MR COSGROVE: Is this becoming an increasing problem because of the rise in the rate of job turnover amongst modern employees, that they are wanting to take benefits from one fund to another as they change their workplaces?

MS GALBRAITH: This isn't so much at individual employee level, this is really at fund level. It is usually when a fund either wants to wind up completely to terminate or merge with another fund or move - sometimes it is just a category of members, sometimes they will want to move. So it has actually been more driven - again, outside the terms of this review - by things like surcharge, which for some - corporate funds in particular are the ones where - particularly defined benefit ones and it was like the death knell for them. It was just so difficult. Now, for example, if they are looking at collapsing into, for example, one of our funds, an industry fund or maybe going to a master trust offered by a life office, it's actually all about consent. Members can move anywhere with consent. This is to facilitate it without actually seeking individual member consent to the move. If the trustees go to their members and give them enough advance warning saying, "We've found this fund. We consider it provides equivalent rights" - and that's the sticking point - "and we are transferring across with effect whatever," then that enables them to do it without the members' consent. So it is a kind of - I suppose it's a barrier to exit at fund level, fund-to-fund level, trustee level rather than down at member level.

MR COSGROVE: Yes, thanks for that. I hadn't appreciated it.

MS GALBRAITH: Within the private sector there's usually a fair degree of portability. The life products tend to have some exit fees which prove issues and public sector - I saw a couple of your earlier submissions - public sector obviously are not under SIS and they have their own issues about portability.

MR COSGROVE: So are you able to tell us whether this is a relatively widespread problem of interpreting how to move to the successor fund or not? If the trustees give their approval, then it's okay? There's no interpretation problem involved or - - -

MS GALBRAITH: The trustees of fund A can move members to fund B provided they have an agreement, basically an arrangement in place with the trustees of fund B to provide equivalent rights. So the trustees of fund A have to be comforted within themselves that - and fund B for that matter - the product design, the benefit design of the new fund is going afford equivalent rights. In the course of doing that there's usually considerable legal advice involved on both sides and usually diverging legal opinions because any given benefit as to another, there will always be some things that are better and some things that are worse, the swings and roundabouts.

As I said, there are still some quite fundamental differences of opinion out there in the legal sector on some really threshold issues like defined benefit, defined contribution. Some will say that under the concept of "equivalent" you have a fairly high test and say that just can't be done. There's no way someone who is a defined benefit member can be given equivalent rights in a defined contribution fund; others disagree. Some quibble about insurance or even things - maybe their level of insurance is the same but the premiums are higher or maybe members go from having employers paying it to paying it themselves out of the account - is that an equivalent right? It really is how long is a piece of string. In the end I think most wind-ups and mergers and transfers do end up happening but it delays them and it costs a lot in legal advice, it really can do. It depends on how similar the funds are obviously to start with.

MR COSGROVE: If you didn't have this provision in the legislation though, all of this would be taking place in the courts, I assume, under trust law, would it?

MS GALBRAITH: Yes, that's - - -

MR COSGROVE: That might be even more expensive.

MS GALBRAITH: Yes, I guess. If someone were to object to it happening to them, you're right, it would end up in the courts. I guess they might be able to put a different test in or maybe just really focus on what "equivalent rights" mean - "It does mean this, it doesn't mean that" - which I know they have gone a long way towards in the circular so it is moving in the right direction, it just still has a little way to go probably.

MR FRENEY: I think it is good to have an equivalent rights concept in here to allow well-intentioned trustees to use this facility to save a whole lot of costs of having to go to individual members and getting their approval. I'd hazard the opinion that it may well be a case where greater clarity either in the regulations or as given by the regulator would help the whole process because you have such a scope for different legal opinion under the trust law. I know from experience what you're saying about the costs adding up for no particular purpose, it gets down to fine interpretations and sorting through legal interpretations, when if there was greater clarity given by the regulator, it would serve the whole purpose and it would prevent that kind of legal debate. Do you agree with that or would you prefer to let it be worked out by the trust lawyers?

MS GALBRAITH: It probably now can't go back to trust law because it's been down this path already. So even if this were to be removed from the legislation, everyone would have it still in their mind-set. I think in the past it probably could have been taken by trust law or just the fundamental fiduciary duty of acting in the best interests of members. But now they've started down this path - I think you're right, I think it just needs to be clarified. As I said, I think the recent circular does go a long way towards it. There probably are only now still a few niggling points, but it was just, I suppose, in the context of a barrier to exit. It was the most obvious one I could thing of.

MR FRENEY: It's very important to allow mobility among superannuation funds and for the benefit of superannuation members.

MS GALBRAITH: Yes, I mean, if it's economically efficient and viable.

MR COSGROVE: My next one is on page 4. Do you have something before then, Roger?

MR FRENEY: Yes, on page 3 if I may - actually I think we've been through this. The defined benefit funds in the middle of page 3 - and you note that the surcharge was the final nail in the coffin, was the inordinate complexity of administering the surcharge legislation. I simply note that, that's fine.

MS GALBRAITH: Yes.

MR COSGROVE: It's a fairly common point that we've been told of.

MS GALBRAITH: Bit of a recurring theme, yes.

MR COSGROVE: At the top of page 4, near the top, the second paragraph there you say:

> While increased focus on the intended outcome of the legislation would be welcomed, making the legislation less prescriptive is likely to lead to increased uncertainty which results in increased compliance costs.

That's a point that some others have made to us. There seems to be something of a trade-off involved here, I guess, between on the one hand this view, which is that we'd really like as much of what we have to do to be set down clearly in legislation as possible. The other view which is that if you leave the legislation fairly general and provide in regulations or indeed, to some extent at the discretion of the regulator, the capacity to interpret that high-level legislation, so to say, then the whole arrangement of that kind can enable emerging problems to be dealt with more quickly than if, say, an amendment to the legislation was required. So in a dynamic sense the latter approach might be more efficient, if you see what I mean. You would still though favour this idea of having greater specificity in law itself, would you?

MS GALBRAITH: I'm afraid I was probably being a bit legalistic in the way I interpreted this in that I took regulations as being legislation and that they've delegated legislation. So I actually took the act and regs - - -

MR COSGROVE: Together.

MS GALBRAITH: I didn't draw the distinction. But I think you're right. Our preferred option is probably for them to be in the regulations, that's probably the best level because they are more flexible, more readily changed than the enabling act.

MR COSGROVE: Yes.

MS GALBRAITH: That or regulated administration, but I think we draw more comfort from actually being in the regulations than - so that's our preferred - so I suppose when I said prescriptive legislation, I meant at that level, not at the statutory level.

MR COSGROVE: So you don't want too much discretion in the hands of the regulator.

MS GALBRAITH: They certainly need an element of it and particularly - I think that's one of the later questions - discretion, the exemption modifications, power that's under SIS and discretion to waive and extend their lives and whatever else. But I suppose there's a point at which - if they're doing that too often in a particular area, then that obviously flags a need for there to be maybe a change in the regulations themselves. That's been an issue since - in the transition from ISC to APRA, noting the difference between when the ISC had a direct relationship with the - responsibility for the legislation now which APRA doesn't, they have to go back to Treasury. You can understand it's changing something, this is regs which is driving us all batty, is going to be low on Treasury's priorities when they've always got budgets or GST or a few other changes to the tax system, a new tax system to bring in. So it's not high priority in a way that maybe in the past the ISC could have had a rechange put through, so that has increased the need for APRA to be a bit more pragmatic in some of its statements.

MR FRENEY: That's fine, thank you.

MR COSGROVE: I'm on 6 next. Have you got anything before that?

MR FRENEY: Yes, page 5, if I might.

MR COSGROVE: Sure.

MR FRENEY: I had a note here. The third paragraph up from the bottom, Fiona, you say:

> Moving to an alternative legal structure would serve to severely weaken the nature of the obligations owned by the fund to the member beneficiaries.

That caught my eye. Could you just elaborate on that for me.

MS GALBRAITH: I guess it's the fundamental nature of fiduciary duties that are owed by trustees to beneficiaries which we think is the logical vehicle for superannuation. It's very similar to a trust given the whole thing of long-term responsibility for investing and maintaining a capital asset for the benefit of third parties. If you remove the fiduciary duties owed by the trustees to members, then not only are any duties that they do owe significantly of a lesser standard than fiduciary duties, but it also increases the possibility they might actually be owing maybe higher duties, stronger duties to third parties. The most obvious example would be, for example, shareholders in a corporate structure. So if you are not a trustee in respect of beneficiaries but are instead a director of a company providing superannuation, then you might actually end up owing stronger duties to your shareholders to produce a profit, whatever it might be, than you would do to the members of the fund.

I guess we feel very strongly that the highest possible duty should be owed by the trustees to the members of the fund. It sounds very simplistic or motherhoody or something to say acting in the best interest of members, but it's really quite a strong tool. A trustee wearing a trustee hat in making decisions are things - the factors that they have to take into consideration, it can make a tangible difference to the outcome of those deliberations and those decisions than if the person sitting there making the decision has a different relationship to that person and is wearing a different hat and doesn't owe them fiduciary duties but owes them some lesser duty. Even a duty of good faith is a lesser duty and where it would end up trickling down to, I'm not quite sure. It's a very powerful duty that one, a duty of good faith, all the duties that have evolved through trust law.

MR COSGROVE: But if you had a company operating under some sort of managed investment scheme structure providing superannuation products, their shareholders' interests are pretty much the function of the success of that company's operations in this particular market, superannuation products. If the company's directors were, you know, in a way trying to disadvantage the fund members in order to improve the company's own profits, then one would think they wouldn't do as much business in the superannuation area than otherwise.

MS GALBRAITH: I'd like to think that but I'm just thinking of two recent examples, the UK one and the Chilean one. Starting with the Chilean one first, that was an example where they had an agency sales force with huge incentives in the Chilean market and it ended up with an awful lot of churning, people going from one product to another for no real advantage. I think it was maybe not unique. But a function of the Chilean legislation is that you couldn't allocate a negative return, you could only allocate a certain - they already stipulated some things. So basically everyone moved to the middle of the road, the market was down the middle, very little product differentiation so there really was no benefit in moving but there was a lot of churning happening. Of course, at the end of the day these people are being paid their huge incentives and bonuses to do that, and the similar case of course which is still unfolding in the UK where there are similar sorts of principles; lots of incentives given to sales force agents to talk - I think particularly teachers, nurses and things - out of their quite generous existing schemes across to schemes that really work to their detriment, to the extent that some of the companies are still paid back significant sums of money. They're extreme cases but it doesn't necessarily mean that what's in the best interests - I mean, the long-term view, yes, of what's in the best interests of fund members by - or the super product by and large will be in the long-term interest of the company and the long-term interest of the shareholders, but they may be taking a short-term view or they may be taking a marketing view.

There are a number of factors that come into play and of course there are a number of circumstances where they're actually diametrically opposed and that's when you see the age-old one of life policies with quite strong early termination provisions to preclude people from moving around. I mean, that is in the interests of shareholders because you lock the money in and if you lose the money, the capital, you're still retaining a fair percentage of it. But it's a bit difficult to support the argument that that is actually in the interests of the policyholder to have policies that have that kind of design.

MR COSGROVE: Could you provide us with information, not today, on these Chilean and UK cases? I have not been aware of them.

MS GALBRAITH: I certainly can, yes.

MR COSGROVE: If you've got something readily available - I don't want you to take a lot of trouble.

MS GALBRAITH: No, that shouldn't be a problem.

MR FRENEY: Just while you're on this point, it's a very interesting one to reflect on perhaps the difference between the very large providers of superannuation services, who might be driven by a competitive drive in the interests of their shareholders to run trusts that were actually conducted in the interests of the members versus perhaps smaller entities with relatively few shareholders who would be the proprietors of the superannuation fund. The very small number of shareholders could benefit perhaps enormously from not doing the right thing. So they could have a cut-and-run kind of approach where, for their own shareholder and proprietorial interests, they could perhaps do the wrong thing by the members of the superannuation fund, with perhaps relatively little penalty other than ASIC virtually running them down and dealing with them. But I could see in the smaller, less conscientious perhaps corporate environment that the proprietors might not be as conscientious and well intentioned as perhaps at the larger end of town.

MS GALBRAITH: Yes, there's certainly scope for that kind of thing to happen, yes, and also even at the larger end of town there are different ways of concealing commissions and things as well. I'm not saying they're all like that but there are tensions there, whereas if you are still in a trust structure, you still have to bear in mind that you are acting in good faith and in the best interests of members - requirements that aren't there if you don't have that relationship there.

MR FRENEY: In many ways SIS is designed to sort of deal with some of these people who are more on the fringes of the industry and who can't deliver to the members of the fund, and if you sort of think to translate that back into an incorporated structure, it probably is a similar sort of problem that you begin with.

MS GALBRAITH: Yes, and the fact that SIS does some codifying of the trust laws, some of the covenants and things that are deemed to be imported into trust deeds, it's basically codifying the trust law to put those obligations and duties on the trustee as a super provider.

MR COSGROVE: Top of 6 is my next point, Fiona. I think I understand what you're saying but I just want to check.

> The concept of equal representation is an apparent anomaly, given the theory of trust law.

Do you mean that the fiduciary duty under trust law is sufficient in itself to ensure that the members' interests are looked after and that the imposition of this additional layer of, if you like, member representation is - well, I'm not sure an anomaly, I was thinking of it more as unnecessary. But have I missed a point there?

MS GALBRAITH: No, that's precisely the point and I guess that's where super has evolved away from the classic - the classic trust law is a settler who settles a capital amount, an amount of money or it could obviously be an estate. It could be Pride and Prejudice, you know, land with entails or that kind of thing, and it's to look after, you know, women who couldn't own property, children and that kind of thing, and they disappeared out of the picture. I mean, often it was because they'd died or the trust operator - it was really just between the trustee and the beneficiary, in which case in that context it's an anomaly because all of the trustees should be acting in the best interests of members and that should be the end of the story.

But there is acknowledgment in present-day trust law cases. There are a handful of them, both in Victoria and New South Wales and overseas which are beginning to recognise - surplus distribution is the classic one - I suppose, the commercial reality, for want of a better word, that is actually really a - it is a tripartite arrangement that the employer isn't just settling a capital sum and disappearing, it's an ongoing liability that they have either under the deed or under SG or under an award to keep making contributions and to do different things.

So even under trust law, they're beginning to acknowledge the fact that the employer is this third party and therefore in that context pure trust law doesn't make sense, but in the super context it does, and equal rep is actually quite a powerful mechanism for ensuring that the interests of both members and employer are balanced and looked after. So it's one of those things that the recent cases have acknowledged that while the overriding duty is to act in the best interests of members, that the trustees need to have regard to the interests of the employers to an extent, and the most extreme case is obviously corporate funds where, if they don't, the employer will wind up - there will be no trust. So in that context, equal rep is still a very valid outcome.

MR COSGROVE: Could you explain to me in the fourth paragraph there, the beginning:

> While trustees of public offer funds should be subject to some form of licensing, for funds which are not public offer funds, this would appear to be unduly onerous.

What's the reason for the latter point?

MS GALBRAITH: I suppose it's a - I don't even know if it's a theory, it's probably more the empirical - what has happened in super which has been the benevolent amateur - and especially equal rep is the perfect example where, if you want to encourage employees to be reps, then if you start going too far down this path, then it's going to fly in the face of equal rep working, definitely deter them, and there's never been a requirement under trust law that the trustee be professional.

Basically it's almost like a jury in criminal law, it's almost meant to be that a trustee brings commonsense and good intentions and all that kind of thing to the table, and it's not to say that they can't and in fact are almost under obligation to seek professional advice. They're not meant to be professional investment managers or lawyers when it comes to equivalent rights or actuaries, auditors. They're meant to seek the advice of professionals but they're meant to be like directors of a company. I mean, there's no requirement for them to be licensed, they're just meant to bring basic commonsense to the table.

I think that it is going to act as a major deterrent for members in equal rep and just generally, and especially for corporate funds, again they're the ones that haven't gone under with surcharge - that might be the final straw. Corporate funds perform a very vital function out there in the industry and it's sad to see even the number that have gone already and this is the kind of thing where if they have to start having their trustees, who are usually management, and staff employees having to look at licensing for them, then they will go under.

MR COSGROVE: What form of licensing do you favour for the public offer funds?

MS GALBRAITH: Probably not dissimilar to the current, where the trustee itself is approved. They look at the trustee organisation and look at its capital adequacy and various issues there. That's actually one of the more powerful tools I think that APRA in particular has, it's not so much SIS itself but the instrument of approval for approving trustees, and the fact that they can impose various conditions there if they see fit. That's actually quite a powerful tool for the regulator to have, and I think that kind of model, that kind of vehicle, is probably ideal.

MR COSGROVE: We now have the FSR Bill in parliament and of course outside our terms of reference but seeming to be looking towards yet another form of licensing for approved trustee funds and perhaps even for individual trustees. Do you have any thoughts on that?

MS GALBRAITH: Only that I know it was tabled on 5 April and I haven't had a chance to read it since I've come back from leave but I guess a lot of it seems to turn on giving advice. I suppose it's one of these things looking at what the person is doing, whether they're just providing a product, whether they are actually providing advice. I guess the only thinking I have again is this uniformity. I can see some merit in uniformity but there are going to be distinctions between people doing different things. Our funds which are only offering to employers, for example, only standard employer-sponsored funds and employers are put in a totally different category to someone who's - whether it's wholesale or retail, someone who's out there offering other products through financial advisers, financial planners, to the retail market, you certainly I think would need different levels of licensing and disclosure depending on the market you're operating in and the product that you're operating.

But of course the FSR is actually going the other way, it's going towards uniformity and a more sort of generic approach. So I guess it's sort of going for that middle of the road - not so much lowest common denominator, but middle of the road and therefore for some of ours I think that it will be a bit over the top - a bit extreme, especially - and, for example, just our standard employer-sponsored funds, who just have employers come along signing up employees and whose distribution is that way, I think it's a bit onerous. There are probably products out there that are operating in the retail market where there may not be as much as they have now and maybe they still need more but I guess ASIC will figure that out over time.

MR COSGROVE: Would you have any concerns about possible duplication of this licensing? You've got the approved trustee "licence" provided by APRA, and we might now have those same trustees being required to obtain a separate licence from ASIC, I guess. Is that - - -

MS GALBRAITH: Yes, and that's what I guess no-one is really sure about at this stage, including ASIC. They're still coming up to speed. The extent to which there will be a transition or - - -

MR COSGROVE: Well, of course it's yet to be enacted, so who knows.

MS GALBRAITH: Yes, and they've yet to figure - I mean, I know they're busy releasing PPPSs all over the place. I guess it certainly needs to be looked at in terms of both transitional - whether people, for example, who are currently an approved trustee under APRA are automatically granted a licence for a certain period of time and then renew it with ASIC and don't have to go back to APRA. I think that's the kind of thing that ASIC is looking at but they're really still making up their mind. Certainly if there's going to be licensing, it should only be one regulator licensing, certainly on an ongoing basis. It is ridiculous duplication for it to be otherwise.

MR FRENEY: Can I just ask in this area, do you think there should be operating capital requirements perhaps as part of a licensing regime for non-JMIFA clients?

MS GALBRAITH: No, well, I was going to say - - -

MR FRENEY: Not to be too frivolous about this, it's always seemed to me that one of the serious risks to member balances and being able to run a superannuation fund smoothly is that you may end up in a situation where you haven't got enough satisfactory working capital to be able to run the fund on a day-to-day basis. I don't think that the net tangible asset requirements on approved trustees necessarily guarantees that you will have readily available operating capital and so I'm just wondering in terms of a robust prudent management legislative framework, whether there shouldn't also be sort of an operating capital requirement to provide the wherewithal that when computer systems fail or have to be replaced or things go wrong, they can be very quickly remedied.

MS GALBRAITH: Yes, that's interesting. If it were going to be done at all, I think the logical distinction again is probably public offer funds.

MR FRENEY: Why is that?

MS GALBRAITH: Maybe in that context it's not as logical a distinction. I guess the most fundamental issue is probably whether or not the funds self-administer because if they're not self-administering then they don't really need much in the way of operating capital themselves because they're outsourcing it. I guess the issue then is whether - well, actually it's quite an interesting economic market issue, whether there are sufficient administrators out there in the marketplace because we certainly have been rationalising over the past few years.

Because, I mean, operating capital is a very real issue for us as administrators and because the amount we do spend on systems in particular - and I have to say, out of the terms of the review, largely tax driven not SIS driven - has meant that we've rationalised and, for example, industry fund administration - Nexus, which was part of National Mutual, went to Suncorp in Queensland, which then went to AAS at AMP which is now CAD. So there really are only two of us of any viable size in the market and a few that do one or two smaller industry funds.

MR FRENEY: If I can just interrupt for half a minute, it probably doesn't matter where the change comes from, even if it's a tax-driven change, say, to incorporate that tax-driven change into a software package can be a very serious challenge in itself and it's not just a question of implanting the new tax provisions into your software package but it's not corrupting the rest of the software package that runs SIS requirements, for example, so you could actually have the whole software package under some risk, that software package doing a lot of what SIS requires through some tax imported change.

MS GALBRAITH: That's exactly it. It is pretty well fully integrated. I mean, you go in member-by-member record and we have 3 million member accounts, so we are talking significant volumes and that is part of the issue. It is in there satisfying SIS preservation, but also recording, storing, calculating, whatever, tax stuff as well and reporting on it if we need to. I mean, surcharge costs a significant amount to implement and having said that, family law and super, which we strongly support the policy of and the principle of, but it is going to cost a significant amount to implement that, particularly more in the way it was initially legislated, which was they weren't allowing the split to occur at the time of the order or agreement. The split wasn't going to occur at that point and if that had gone through, running two people out of one account or three or four would have been a nightmare. As it is, it is looking like they are going to allow us to split at the time of the order agreement, which just means we will just create a separate member account and it will be much easier.

You are right, that is a very real issue, but we found surcharge in particular and we are only defined contribution funds, we are only contribution funds, but it took an enormous amount to integrate that into our system so we could do the reporting to the Tax Office and the deductions of the surcharge assessments when they came in and reconciling everything. You are right, everything has to be rigorously tested, system tested and user acceptance tested to make sure that it hasn't inadvertently - you know, the unintended consequence that you get in legal drafting you also get in computer systems, so you don't suddenly run a review and find that something has gone wrong. So it is a very real issue, but most funds do outsource administration, so I imagine it would be difficult to impose an operating capital requirement on the trustees for that reason.

MR FRENEY: Even then, whether it is outsourced or not, it can very much be a self-induced problem and one that the trustee has to deal with. You will be aware of the publicly reported Excelsior superannuation plan that ran into this very problem of computer system and software package change and in essence didn't have the working capital to deal with problems that emerged. It seems to me that whether it is an outsourced arrangement, whether there is indemnity, whether there is insurance, the bottom line is that you have to be able to keep computer systems running every hour of every day to accommodate members' requirements. When you can't do that, you start to run into very serious operational problems that are extremely costly to rectify. I am just wondering whether you agree with that and whether you think it's an issue for a legislative framework.

MS GALBRAITH: It is interesting, because I was going to raise insurance as a possible alternate to that with HIH in the back of the mind, but insurance doesn't actually often solve the issues. It is more a case I think of just keeping the databases as up to date as possible. It is one of those things that if you can't afford basically to make the change in the system to do whatever it might need to be done, so long as your databases are as relatively accurate and up to date as it possibly can be. I mean. at the end of the day you can always go to another administrator if needs be, so long as the records are okay to transfer across. I think that was one of the problems with Excelsior, they weren't in a sufficient state to be able to.

I guess that is one where - you probably rely again on a combination of trust law. I mean our trustees are vigilant and they are always on our back for feedback and give back reports on where things are. We are always being audited, internal audit, external audit, and I guess that's where prudential supervision comes in. It's that kind of thing in particular that should be the key focus of the rigorousness of computer systems and the accuracy and completeness of databases.

MR FRENEY: Do you think SIS is adequate in this regard, or whether the protective legislation should be strengthened - - -

MS GALBRAITH: I'm not sure how you can really prescribe - I mean, it's just a fundamental thing that - - -

MR FRENEY: - - - by requiring the trustee to have a certain amount of operating capital.

MS GALBRAITH: Which I guess in one way they do in that they pay us fees to do what we do, so they - - -

MR FRENEY: What you do, yes, but there would be many corporate trustees that either would be outsourcing or running it themselves, but if something went wrong wouldn't have the wherewithal to fix it quickly.

MS GALBRAITH: Yes, I guess if we had an issue - it's an interesting issue and I really don't know how to address it.

MR COSGROVE: How would you write such a requirement, do you think? Would it have to be expressed as a proportion of assets?

MS GALBRAITH: I think it would have to be and then - - -

MR COSGROVE: A dollar amount wouldn't be suitable for the range of - - -

MS GALBRAITH: No, because it's quite a diverse industry.

MR COSGROVE: - - - administrators or funds or whatever the case may be.

MS GALBRAITH: I guess that touches on the other one later, the levy and the fidelity funds and those kind of issues, whether it is done that way, whether the industry as a whole funds something - but I think the major thing with these is partly having the resources to do it, but also partly detecting it in time. I mean, that was part of the problem with Excelsior, that it was the state that it got itself into before the resources were put to it.

MR COSGROVE: Anyway, thanks for discussing it.

MS GALBRAITH: It's a tricky one.

MR COSGROVE: My next question is down towards the bottom of that page. The third last paragraph, Fiona, you say the drafting of some of the provisions is less clear than the things you have mentioned in the previous paragraph and a comprehensive review to identify the policy objectives underlying the legislation and to ascertain whether they are reflected in the legislation as drafted would not go amiss. This raised I think a more general question as to whether the SIS Act has clearly identified the problem and the objectives on which it is meant to be aimed, whether it should have a single objective or these multiple objectives. You have retirement income policy objectives, prudential supervision objectives, revenue collection objectives. As I think you have said, there is quite a bit of ground covered in this piece of legislation. Is that efficient, do you think, as an approach to regulation or would it be better to have a more delineated set of pieces of legislation, each of which would have a more clear, perhaps even a single objective, be it revenue collection or prudential supervision? Do you see what I'm asking?

MS GALBRAITH: Yes, I do. I think at the end of the day the form probably doesn't matter so much. I mean, whether we had an umbrella SIS with - you could almost have three different divisions, you could have a retirement income policy, revenue protection, prudential supervision, or whether you put them in separate pieces of legislation. My initial reaction is I would prefer to see it in one piece of legislation as one product. It is much easier to look at one piece of legislation to identify what you need to do.

But having said that, there would be merit in the alternate case in that if those pieces of legislation were owned by the relevant regulator, there would be maybe clearer development maintenance, ownership of policy and a clearer feeling for the outcomes and objectives which could still be achieved in one piece of legislation, but it needs the various parties to communicate more clearly. A lot of the operating standards - I think I made reference to this - in SIS of course have their antecedents in the Tax Act and their revenue protection more than anything else. Some of them are retirement income, but most of them come out of the fact that it is a concessionally taxed product and therefore trying to avoid tax avoidance and minimisation. There's probably a mix of retirement income policy and revenue protection in that amount and a lot of it isn't prudential. A lot of the operating standards are not prudential. I guess that is really what Mr Freney was just touching on then. That's probably what gaps there are in SIS. There are probably some prudential ones that could be added.

In terms of then who administers that piece of legislation, I think that is one of the issues and I think that's one of the other questions. When it was owned and administered by the ISC there was a synergy that came from the fact that it was one regulator, one policy area to develop the policy, corporate memory, internal communication. While they have done it, they've carved it up and allocated certain specific provisions to ASIC - - -

MR COSGROVE: Yes, a functional division.

MS GALBRAITH: Yes, functional. It is very tricky for ASIC to think to do that, because they've inherited - very sensibly for administrative purposes for the sake of the industry, but they've agreed, for example, to endorse and adopt previous ISC and APRA provisions on things. That's not to say they won't change over time, but sort of on a business-as-usual basis, but by the time they come to looking at some of those, they have neither the corporate memory nor the involvement in the development of them in the first place to really appreciate the policy objectives behind it in a lot of cases, and of course the last place you'd want to turn in a lot of instances is the EM or the ES because they often don't explain - some do. I mean, like anything, it varies a lot depending on who actually drafted it but I think some of the policy behind things gets lost down the years in translation.

With APRA I don't notice it as much because I deal with the Melbourne office which has had less of a turnover, but certainly in Sydney and Canberra there's been such a turnover of staff that people genuinely can't remember some things we're trying to achieve, and that makes it very difficult all round as an aid to interpretation or application, and I think some of it probably could be revisited. The one we touched on before, equivalent rights, was a classic case in point, but there are certainly a lot of others.

MR COSGROVE: I'm not quite sure I understand the practical effect of what you are referring to here. If you look at SIS at present, every part begins, "The object of this part is," blah blah blah, and that's clear enough in a sense, although the objectives are set at a fairly detailed level. Are you suggesting that we should have a statement of broader objectives somewhere in the act that sits on top of all this detail? I'm not quite sure what you have in mind when you say that some review of the policy objectives underlying the legislation would not go amiss.

MS GALBRAITH: I was thinking of the logical vehicle being the explanatory memorandum or the explanatory statement, and instead of doing the trend, which is to reiterate, "New section 190 will," and it just basically either quotes or paraphrases what clause 19 currently says, to actually explain in that context - it could actually be a one-liner but just what that's trying to achieve - and I think some of that is missing. I wasn't going to mention lost members but I actually have prepared a paper on it for the ISC some years ago, where the policy announcement was that small members' balances would be protected against erosion via fees and charges and lost members would be reported. By the time it has translated to legislation it has turned out that lost members are also protected regardless of account balance, which is causing a lot of issues.

I've pointed out all the treasurer's press statements, all the chronology, and I've argued quite strongly about why we're protecting lost members. If they're small as well, if they're under 1000 - the problem is most members are both lost and small, but you can get some lost members with quite significant balances. You can have the twin members who join the fund on the same day, same contributions, all that jazz; you get to a certain point in time and just because one of them you don't have a current address for and the other one you do, you're suddenly protecting the one without the current address, and the "What are you protecting them against?" sort of issue.

No-one really has a feeling for the policy behind and if you look at the explanatory memorandum, the explanatory statement, by the time it's got to the point of regulations it's just doing the reiterating - until I went behind it to the press release announcement of it to see, and the policy intent wasn't to protect them, it was just to report them. But there's no-one around - and often it comes down to corporate memory - who literally remembers that that's what the policy was. It would also I think really help focus the drafting as well. Sometimes if you actually have to put, even in a sentence, what you're trying to achieve with a particular section or regulation, that actually helps focus on whether or not it's been achieved. I think that's probably the logical vehicle and as the name implies, that's what it's meant to be doing, explaining, but most of the time it just does reiterating.

MR COSGROVE: I see what you have in mind now, thanks.

MR FRENEY: I can't resist - on page 8, second-last paragraph, I'm very pleased to see you saying that:

> While the investment rules may have become a little complex, this was largely in response to certain practices occurring within the industry.

MS GALBRAITH: It was.

MR FRENEY: We'll get that on the record.

MR COSGROVE: On 10, this is the regulatory overlap issue. It's effectively the middle paragraph, the one beginning:

> The arrangements can result in uncertainty -

this is because you've got more than one regulator -

> where two or more regulators have developed a position with respect to a particular concept which, while it may fall clearly within the province of the provisions which they're administering, may touch upon a provision administered by another regulator.

What examples could you provide us with at that time?

MS GALBRAITH: It's the dreaded lost members again.

MR COSGROVE: I see.

MS GALBRAITH: An example of this is it's defined in SIS reg 103AA, I think it is, and that definition is used in - actually this is an interesting stand because it's not APRA and ASIC which is where you classically expect. It's actually APRA and the ATO. The lost member and unpaid moneys reporting now has been removed from SIS into a separate act which is now a tax act administered by the Tax Office. It hinges on the SIS definition of "lost member". So lost members both have to be protected which is the part I'm querying policy-wise but also reported which I'm querying policy-wise.

Now, you will find sometimes that ATO might give a particular interpretation of lost member for their purposes for lost member reporting and that may be in conflict with what the ISC said previously, but their interpretation of a lost member definition for protection and reporting when it was under SIS - and because it has been effectively replicated in the other act by being incorporated by cross-reference - and I think we're going to see similar things like that happen with ASIC in particular with information disclosure because the concept started in SIS and some of the things you have to disclose rely on other concepts that are in SIS, and ASIC in particular doesn't necessarily always appreciate the antecedents to that particular provision. So there probably haven't been too many because ASIC has been fairly open but there is always scope for that to happen and then you get into the chicken and egg cycle.

MR COSGROVE: Yes. I think Mercers who were with us before you came along this afternoon, Fiona, was citing an instance that might - yes, modification declaration 23 means that SIS now requires the determination of three different values for the same pension and they set those out. Then they say:

> These values are in addition to a value determined by an actuary for tax purposes, a value determined by the Department of Family and Community Services for assessing whether there is a deprived amount for pension purposes, and a value specified in the fund's own rules used for commutation purposes.

So they say there are potentially six different values for a particular pension, five of which are legislated. Would that again be an area where - this is not so much different regulators I suppose as different pieces of legislation for the most part, five out of six, which are specifying different values.

MS GALBRAITH: Yes, and I think that's it. That's why we almost need in some instances to go right back to policy and try and figure out what is trying to be achieved by that in this case - the purposes on which you determine that value. There will be some instances where you might end up with, I could understand, maybe two or three different valuations because it is actually being done for a different purpose and a different context.

MR COSGROVE: Different purposes, yes.

MS GALBRAITH: But having said that - and the trick in this is the absence of communication between the different departments and the different policy-makers in particular right back at policy level about what they are trying to achieve, what their outcome, and even lack of awareness that these other ones exist and that they're used for different things, because there could obviously in some instances be agreement to split the difference and go for some middle value or choose one over another, even if it meant a slight loss in revenue for the Tax Department or a slight increase in social security benefits, whatever it might be. Obviously the policy people would have to look at it. Certainly it's compounded by the fact that there are issues in SIS where some things are defined two or three times with different meanings or they looked like they should be defined too but they're not actually defined anywhere, or instances like that, so SIS itself is a piece of legislation.

MR COSGROVE: Yes.

MS GALBRAITH: I mean, it was a huge task, a commendable task, that they did at the time to completely revamp it from OSSA but that's what I mean - things like that as well, a policy revisit, but also once you have revisited the policy, then a drafting revisit probably wouldn't go astray in some places as well.

MR COSGROVE: Yes, thank you. Down the bottom of that page, and this again is a point of clarification, you say:

> Material published by the regulators can reduce the costs of compliance by increasing certainty -

and so on.

> That's especially useful when the regulator does not have direct input into the legislative processes.

Is that right?

MS GALBRAITH: That was me thinking of APRA. In the past the ISC could probably take something on board and go and have the regulations changed. It was in the context of thinking when - now APRA is one stage removed and has to go via Treasury and fall to the bottom of the list.

MR COSGROVE: I see.

MS GALBRAITH: It means that they can actually adopt a position and decide to administer it on a particular basis that may not be in strict compliance with the legislation as drafted. So it's a useful vehicle for them to say, "While SIS reg - this says that, we're adopting this particular position with respect to administration." That's when it's particularly useful and I think ASIC is probably in a similar boat, whereas the ATO, for example, has more scope to actually go back and change a reg, whatever, because they have more direct lineage into the Tax Act and tax regs. So yes, that was very staccato but that's what that was driving at. It's useful all around. I mean, the ATO is very good for publishing things when it's outside the terms of the review but publishing things on its Web site to give guidelines on different things, so it is a very useful mechanism for administrators and regulators to use.

MR COSGROVE: Anything else?

MR FRENEY: Just on page 11, the Complaints Resolutions Act, I just wanted to tease you a little if I could about the question of imposing a levy. You say that you think perhaps a levy is not needed because the tribunal has the power to treat, as withdrawn, complaints which it thinks are trivial. I think one of the problems is the sheer number of complaints that actually the tribunal receives and then has to consider and the very high proportion of them which it finds are outside its jurisdiction, so that if there was only some sort of process which saved the tribunal receiving a large proportion of complaints which it doesn't have jurisdiction over and having a lodgment fee might actually get people thinking.

MS GALBRAITH: Yes. I'm not sure that that - it's an interesting thing to strike the right balance with the fee that's not too large to deter people but I'm also not sure that some of the ones that are outside the jurisdiction are usually - I mean, by definition they have had to go through the internal complaints process already so already the fund has probably tried to educate them that it's outside the terms of the SET but having said that, it's also mandatory that we put the wording about the SET into, for example, responses to complaints, and it's a grey area whether we're giving too much advice about it.

Just from what I have seen I have just had that funny feeling that those ones are the ones that probably a fee may not even deter. At least those you say would be partially cost recovery, but they can be fairly zealous about issues and go ahead. What worries me is the countersigned, which is the ones who have genuine issues who are deterred by a fee, and if you strike it high enough to act as a deterrent, it may deter the genuine ones. If you strike it low enough, then I suppose, as I said, it does go part-way to cost recovery, but given super, given again that's compulsory and that it's deferred wages and salary, and it's something that people didn't have a choice about going into in the first place, I think that does warrant access to a free dispute resolution mechanism in a way that other products may not, so - - -

MR COSGROVE: How about a refundable fee if you're successful?

MS GALBRAITH: A bit of determination goes in your favour.

MR COSGROVE: Yes.

MS GALBRAITH: I'm not so sure about that one but an interesting thought. Yes, I think that probably has some issues with it as well, but yes.

MR FRENEY: I think I have probably got a last question which is people have said that one of the major costs of SIS has been the frequency and volume of change of SIS. However, in recent times that has slowed and members, the ultimate beneficiaries, are perhaps benefiting from a quieter legislative framework, one that people can operate within. I mean, I know there are exceptions, the surcharge in the family law and all those various things, but in terms of SIS itself, there hasn't been quite as much change other than the in-house assets rules. I'm just thinking if, as a result of our review, looking forward into 2002, that - as most people have been saying to us, the SIS Act itself is a good act - it's doing its job but it could benefit from further refinements, and quite a few refinements that people are pointing to, would the industry be able to cope with a number of changes? Would you be able to cope with a number of changes to the SIS Act that sought to perhaps strengthen it somewhat but in particular sought to reduce compliance costs?

MS GALBRAITH: First of all, I'm just going to agree with what has been said. I think SIS had its initial settling and teething but it really has settled down and it's been tax that's reared up to take its place. Looking to 2002 in the terms of that kind of time frame, I must admit the industry is going to have its hands very full with the financial sector reform, privacy coming in as well which is a significant issue for us, and also family law, when it does arrive, will be significant issues. We would probably prefer to see it in the next (inaudible) and it really depends on the nature of changes that are being made.

The kind of changes I think I would like to see are probably almost more in the way of drafting changes, almost more in the form of just clarifying what the industry has sort of finally settled, the positions that have been settled by the regulator and by industry practice, but every now and again you will get a new auditor and you have got to sort of dig out the old letter from APRA or the circular and you have got to keep reinventing the wheel. There are things like that that obviously would take resources from a legislative end but not from our end. If it were just a matter of, say, reissuing the legislation, but amending the legislation for the sake of clarity, then that's obviously going to have a positive impact on us in terms of it won't require us to make any changes and it will obviate the need to go through heaps of auditors and things in the future.

I guess if some of the more substantive changes I'm thinking of are more in the way of - because I'm obviously coming from a purely administrative focus. If you're looking at incorporating, for example, some more prudential measures that will impact more directly on trustees, then that obviously doesn't impact on the day they admitted the fund. It may have some implications to the trustees themselves but less on us, so I guess it's the middle ground ones. If there is some tinkering done with - substantive tinkering, not just redrafting - but a review of policy or an introduction of new policy which is usually more, as I said, in the way of things like retirement income policy or revenue protection which are probably not the kind of things you're looking at but - - -

MR FRENEY: What about age limits and contribution limits and cashing-out limits and those sort of things?

MS GALBRAITH: One would hope they would be going, in which case if they're going - - -

MR FRENEY: Let's say they're going, yes.

MS GALBRAITH: - - - that would make our life a lot easier. I mean, as I said, if there were those kind of changes - - -

MR FRENEY: We can cope with that.

MS GALBRAITH: I would tear up that policy, that procedure, exactly. That one we can cope with quite easily and would happily endorse. It's more a case of - - -

MR FRENEY: Cope with savings but not with the additional costs.

MS GALBRAITH: So it's just more if people get introduced. If you were going to tinker with those, you know, to change them but not remove them and we have to revisit, change the age from this to this, so we had to go and change everything from that age to that age, that's a pain and that would be difficult to incorporate in the coming sort of financial year, but removal of things, yes, and that is - I mean, the occupational nexus is an interesting one and spouse contributions are really - well, if not blown out of the water, have come close. The age based ones, I mean, they are a bit more difficult because of the revenue, there's a revenue issue there, but having said that, there are RBLs, and there are changes to the death benefit of RBL now who it's measured against and - I think that was back in 94 - different things have happened. That's what I meant again by revisiting policy.

There are things like that that a lot of people out there probably even aren't aware of. I know I have to keep defending our age 65 practice both in terms of the fact that it has to be done because the legislation says so, but also giving people a feeling for the policy as to why it's there, but having said that, I think a lot of people don't even realise the policy behind it. I think looking at that and saying, "Are there other means of achieving it," particularly ones that are already in place like RBLs, "Is that enough? Are other things enough?" and hopefully just letting it go or conversely if the Tax Office, and the Treasury Department most importantly, wants to retain it, then I'm not quite sure. Those ones are tricky ones, the compulsory payment and contribution standards.

MR FRENEY: Is there only so much change you can deal with at any one time?

MS GALBRAITH: Yes.

MR FRENEY: Or is it better to have change all happening at once? I mean, you cited FSRB, privacy and family law as enough for you to deal with in a 12-month period, whatever.

MS GALBRAITH: Yes.

MR FRENEY: If you thought of changing SIS for competition policy and cost-benefit analysis reasons - and let me make it even a bit more complicated. If somebody had a more significant redesign of SIS in mind that John was asking a question about, whether there's a different approach to SIS from a higher level structure of legislation tiering down more into regulations and a regulator's discretion - let me reask the question. Is there only so much change you can deal with at once or is it better to have all of the change at once, a big bang?

MS GALBRAITH: There is definitely only so much we can cope with and I think we do - the industry as a whole has more than enough on its place at the moment with FSR, privacy and family law in the wings. I guess it really depends on again how substantively you're changing. I mean, you could be stripping back the legislation and enacting three separate deals, administered by three separate regulators, whatever it might be, but at the end of the day, if we're still preserving all money that comes in the door and if we're still hanging onto the old preservation - you know, if that's not being done away with, and if we're still taxing the way we're taxing and if we're still doing surcharges - I know that's outside your domain - then it really doesn't matter.

If the source changes, if it was this section 10 and it's now the Retirement Income Policies Act, section 20 and something else is now sourced in the Prudential Provisions Act and something else is sourced in the Protection of Revenue Act but it's in essence the same thing, then it's a pain for someone like me to have to go back and redo all our check lists and redo the column that does all the cross-referencing about the source of the obligation. But if the obligation itself is staying the same, then it only impacts on my department and not anybody else's.

If while you're at it - and I know there are some changes and we are going to do away with - it depends what it is. I mean, there are systems changes. As I said, systems and procedural and documentation are probably the major three and it really depends on what it impacts on, but all three of them are - I mean, IT is the most expensive. But procedural changes can take a surprising amount to develop procedures and train staff and get rid of the old ones, and documentation is the same. The other thing to bear in mind is it impacts on members, and if it impacts on members, that really impacts on us - us in particular because we run call centres.

Preservation has improved a lot. Since the introduction of preserving all new contributions, it's made it a lot more straightforward. The grandfathering is already in place in our system, so there's really probably not much point in worrying about them. Obviously we have the grandfathering because the regulator as a whole has gone for equity over simplicity, but having said that, most of it is already in place. But if, by chance - retirement income policy grounds or whatever - that were to be done away with, I don't know how much it would take in our systems, but it would take an awful lot on the phones - a lot of scripts and a lot of training for staff - how to deal with irate members and a lot of education of members and that kind of thing. So a lot of it spins off into areas - and it really is quite across the board with the whole organisation, so it may appear relatively - and it's often in inverse proportion. The smaller the change in the legislation - the removal of one word - can lead to the biggest consequences for us and vice versa. You could probably move entire chunks of SIS and we wouldn't miss them because we don't ever refer to them, particularly the ones pertaining to the trustees more directly and not to the administration.

The area that is particularly problematic is things like a public offer, for example, which is drafted holus-bolus, picking up from Corps Law, and it uses Corps Law language and things like that. We could do with that being put into super language rather than Corps Law language, so it really depends on what you're thinking of doing, but you'd probably prefer it later rather than earlier. I mean, it is working well.

MR FRENEY: You'd have a dollop of help or two with lost members and spouse contributions - - -

MS GALBRAITH: Yes, wouldn't mind a little bit of tinkering along way. But I mean, by and large, it is working very well, so it's on the, "If it ain't fixed, don't fix it." Prudential is probably the one - the retirement income policy and revenue protection have well and truly settled down. The prudential is probably the one to maybe look at.

MR FRENEY: So you're saying that it can only cope with so much change at once and if you are thinking of quite an agenda of change perhaps from the three that you've identified and then other changes that may be recommended that the government would pick up, it's better to phase those through time?

MS GALBRAITH: And also, I think the industry would very much like to be consulted on the changes - - -

MR FRENEY: Certainly, yes.

MS GALBRAITH: - - - which is not going to happen - - -

MR FRENEY: We've got that message, yes.

MS GALBRAITH: Yes. FSR in particular - disclosure is disclosure. Mind you, we've settled down - that's one area of the regs that were amended a couple of times in the first few years and have pretty much been left alone, the member statements, the annual statements. That's all kind of settled. So even just moving it across to ASIC - and they will probably use different language - there'll be lots of toing and froing, "Does this mean the same as it used to?" - and all the kind of jazz that happens.

Licensing is a totally different regime for most of us though. For example, our company as a whole is probably looking at having to be licensed which is something we haven't had - our public offer funds have dealer's licences. That one in particular in the industry - those areas of the industry that haven't classically been involved in it - and it's huge learning curve for ASIC. I think that's part of the issue, and they haven't been as directly involved with it as they might otherwise have been, so they're on a learning curve too. That one in particular is a huge transition for the industry as a whole. From what I believe - not having read it, but from what I believe - and even though I believe it's changed a lot from the original one, it still has some of the fundamental tenets in place and I think you really would have to allow the industry the full 12 months to kind of cope with the adjustments to that before they were hit with anything else.

MR FRENEY: Thank you very much.

MR COSGROVE: Yes, thanks, Fiona, for a really thoughtful session with us. Thanks for bearing with us late in the day.

MS GALBRAITH: Thank you.

MR COSGROVE: I think now we will conclude and we are going to resume tomorrow at noon.

AT 5.40 PM THE INQUIRY WAS ADJOURNED UNTIL
WEDNESDAY, 16 MAY 2001

INDEX

	Page
CORPORATE SUPER ASSOCIATION: MARK CERCHE NICHOLAS BROOKES	90-113
TOWER TRUST: PAT O'BRIEN	114-120
INDUSTRY FUNDS FORUM: IAN SILK	121-131
PRICEWATERHOUSECOOPERS: LEN GAINSFORD CLAIRE KEATING	132-146
WILLIAM M. MERCER PTY LTD: RAY STEVENS STEPHANIE ARMSTRONG	147-166
JACQUES MARTIN INDUSTRY FUNDS ADMINISTRATION: FIONA GALBRAITH	167-193