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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 WEDNESDAY, 16 MAY 2001, AT 12.03 PM

Continued from 15/5/01

MR COSGROVE: We are resuming the hearing in Melbourne this morning, and our first participant is IFSA. For the purposes of our transcript, could you each identify yourselves in the capacity in which you're appearing today please.

MR STANHOPE: Bill Stanhope, senior policy manager at IFSA.

MS HOWARD: Kerry Howard, general counsel, Merrill Lynch investment managers. We're a member of IFSA.

MR BOYNTON: Jim Boynton, partner, Mallesons Stephen Jaques. We're appearing on behalf of IFSA.

MR COSGROVE: Thank you. Well, we understand you plan to speak to us on the basis of some notes which you provided recently, so go ahead.

MR BOYNTON: What IFSA would like to do today is to run through and compare the Superannuation Industry Superannuation Act of SIS with the Managed Investments Act, otherwise known as MIA, or more correctly chapter 5C of the Corporations Law. It's IFSA's submission that they cover much of the same ground, and these are for products which IFSA members provide to customers with essentially the same underlying investments. For example, the Australian Equities superannuation fund, the Australian Equities managed investment scheme are getting the same exposure to the same assets. To do that, IFSA members and non-IFSA members have to comply with two regimes, the SIS regime and the MIA regime. This results in some overlap and some duplication, as far as IFSA members are concerned, and IFSA's submission is that a single scheme would overcome that duplication, a single scheme for people who fall into the two camps.

There's a little background on IFSA that would be helpful. It has approximately 90 members, and they manage $600 billion in assets for people who have superannuation in managed funds, but also wholesale investors. As I say, essentially from an investment perspective, and Kerry will touch on this, they end up in the same pools. The products are established as trusts invariably, in both regimes, and one issue which we'd like to address first is the use of trusts under both. Interestingly under SIS, to be a regulated superannuation fund, you don't need to have a trust, or a trust structure, and this is partly, I think, to provide for public sector schemes where they may not be set up under a trust. But even though the SIS Act speaks in terms of a trustee, if you look to the definition of what is a trustee, it's actually defined as either a trustee within the normal meaning of that term, or if there isn't a trustee, the person who manages the fund.

Having said that, for the IFSA membership, by and large, there are what are classified as public offer entities under SIS, and if you do have a public offer entity then one of the requirements is to establish - I'm sorry, I'm not quite sure of the exact words - but it's to the effect that it be constituted as a trust. I think certainly in my experience, and I draw on about 14 years of experience, invariably if they are not a public sector scheme, they will be set up under a trust. Managed investment schemes once again for the IFSA membership are invariably set up as trusts. There are a few

reasons for that. The first is chapter 5C requires all scheme property to be held by the responsible entity on trust. That's quite clear. The second thing is income tax laws actually encourage the use of trusts for managed investment schemes where they want to get the flow-through tax treatment. They set it up as a unit trust, and so essentially, rather than a trust being taxed, it's the unit holders in the trust who are taxed on the income and gains in the fund.

So I think in my experience both vehicles are set up under trusts, plus both SIS and Corporations Law codify trustee duties and impose duties on responsible entities and their officers. If you look at the key provisions in both SIS and MIA, there's a lot of commonality. For example, each have to act honestly. Each have to comply with what I'd call a prudent person test. Slightly different formulations, and perhaps surprisingly to some, the MIA test I would say is probably higher in that the SIS test is based on an ordinary prudent person, whereas the MIA test has regard to a responsible entity in those circumstances. So if it's a professional responsible entity, impose a higher standard on that. Each of them must act in the best interests of their members. MIA goes a little bit further, and so if there's a conflict between the interest of the members and the interest of the responsible entity, the responsible entity must give priority to those interests of the members. Each of them impose duties to separate the assets from the personal assets, and each of them have similar enforcing and monitoring provisions in the act.

It's probably worth reflecting a little bit on the history of the two regimes. In the early 90s, the sort of products that IFSA members provide were in part regulated both by the Corporations Law. If you offered to the public, then you had to have a manager and a trustee. It didn't matter whether it was superannuation or non-superannuation money, and then as a result of the Australian Law Reform Commission reports, moves were afoot to say, well, that dual party entity should be replaced with a single responsible entity. SIS did that in 1994.

It took the non-superannuation industry a bit longer to come under the single responsible entity regime in 1998, and subject to a transitional period, but they've sort of come from the same background, if you like, and even though in my view SIS talks in terms of trustee and MIA talks in terms of responsible entity, the net effect, having regard to those similar, if you like, codified trustee duties, and the fact that one has to hold scheme property on trust and the other has to be constituted a trust, there's a lot of similarity there. That's not to say that there is ground covered by SIS which is not covered by MIA. I suppose you'd put them in retirement incomes policy-type provisions, and I think other submissions have covered these things like restrictions on borrowing, charging, having to have an investment strategy, the operating standards which restrict who can contribute, or when they can contribute, when they can take the money out. Interestingly, one thing that SIS has that MIA doesn't have is a cooling-off period for retail investors, but that is proposed to be brought in for managed investment schemes under the Financial Services Reform Bill. So yes, there are, if you like, special rules for superannuation, but there are a lot of similarities, and the pivotal sections show that, I think.

Somewhat surprisingly, given the objects of the act, the two acts, they seem to

have come with slightly different purposes in mind. When you look at the detail, you find a lot of commonality, and in fact you find that in some cases there is either greater obligations or greater liabilities for responsible entities of registered schemes and super schemes. I can give you some examples of that. The duties, and it's worth just mentioning when you look at the duties under SIS, under section 52, if you breach those duties, it's not an offence. It gives someone a civil right to recover loss or damage, but it's not an offence. So for example if you didn't act honestly under SIS, that would give rise to a right for loss or damage. Under the Corporations Law it's actually a criminal offence. It's an example of where they have more teeth. There's actually other duties imposed within that framework on registered schemes, which aren't imposed on superannuation. The entity must ensure that the entity complies with a compliance plan. I think the compliance plan, if I can, I'd like to come back to. They also must ensure that there are regular valuations. They must ensure that, to the extent that it's not inconsistent with the law, they comply with the duties and the constitution.

Once again, from a technical perspective, what that says to me is that superannuation law, if you breach the trust deed and it's not a breach of the law, then the remedy is for breach of trust, but there's not a remedy for breaching the law. I think that was one of the reasons why SIS codified the trustee duties in the first place, because it recognised the difficulties some people may have in enforcing for breach of trust. Contrast that to a law for registered schemes, and you find that if there's a duty in the constitution which you breach, not only does it have the civil consequences, you'd have a clear right set out in 5C, but there are also criminal consequences attaching to it.

I think there will be time for the managed investments regime to settle down, and I understand there's a separate inquiry on review of managed investments, but it does actually at the moment go further in things like liabilities for agents. Under SIS you can appoint an agent or a delegate to do things for you, and the position is, so long as basically you are properly appointing that agent, and you monitor them, if the agent then acts outside that authority, then there's no liability for what the agent does. Contrast that to managed investment schemes where there is liability for acts of agents regardless of whether they're inside or outside authority. So I think you're getting the sense that, yes, consumers in this regard have either the same level protection, or in some cases better. Another example would be in relation to related parties. SIS deals with related party investments. It has some rules in dealings when you deal with members. The Corporations Law provisions are just more extensive. They cover a broader range. It's not just investments. It's other dealings with related parties.

The next thing is for public offer entities. Under the managed investment scheme they must have a dealer's licence, and it's a special dealer's licence which authorises them to be a responsible entity, and if you have a public offer superannuation fund, you must also be an approved trustee, approved by APRA. The requirements in the legislation are similar in that essentially there's one way you can get a licence with the capital is if you've got $5 million in net tangible assets. Another way is to appoint a custodian who has the same, and there are different

variants, depending on which legislation, but there are similar requirements. To provide these two types of products, it's necessary to apply for two licences effectively. Now, I think the regulators have gone some way into cutting down the duplication in that you can use the same material that you used for, say, dealer's licence, to go with your application as an approved trustee. Then you've got to ask yourself, well, if you use the same material and need to provide the same comfort on, for example, contingency plans, then what purpose does having the two approvals serve?

Once you have a licence, it's then necessary to put in place compliance systems, and I think this is a good way to contrast the law. Under chapter 5C, it's very specific. It says that you must have a compliance plan, and that's to ensure compliance with not only the law, but also the constitution, and constitution in registered schemes speak is the same as trust deed in - or governing rules, more specifically, in SIS speak. It says you have to have that plan. The responsible entity must ensure the compliance with that plan, that plan must be audited, and if you don't have an independent board, or a board comprising a majority of independent members, then you must ensure that you have a compliance committee which does, and helping people through the transition to MIA, a lot of work has been put into getting those plans right, their lodged document. It's very clear, if you like, a compliance emphasis. There's no equivalent in SIS.

There are things outside SIS in that the regulator encourages clients' programs and I think in their audits and visits they will ask people about it, and for public offer - approved trustees of public offer schemes, each year the board has to give a certificate essentially to the effect that they've considered the risk involved in running the enterprise and they have in place procedures for minimising those risks, and also I think part of the annual audit of the scheme there is a compliance audit built into that. But I think the view of the IFSA membership is - well, it's very clear what I have to do under the Managed Investments Act and it's a higher standard, and SIS - if you like, there's less certainty as to what you do and there's less teeth attaching to it, legislative penalty for not doing it.

The next example I'd like to give of the duplicate is in relation to custodians. As I mentioned, there are requirements for custodians from both SIS and ASIC. They have taken steps to make them consistent but nevertheless when you negotiate a custody contract, you have to ensure that there's one set of provisions which you check against what the APRA circular says needs to go in there and another lot of provisions which meet the ASIC requirements and that can lead to more time negotiating different clauses when essentially they seem to be heading into achieving the same result.

Another area is reporting of breaches to ASIC. Under the terms of a dealer's licence you must the next day report any breach of your licence. Also the responsible entity must report to ASIC a breach of the law as soon as possible. In a SIS environment it is different. Approved trustees have to report certain events within 30 days other than that, so that events which aren't specified in the particular section or where the fund is not a public offer fund, the mechanism for telling APRA

about a noncompliance with the law is through the annual return. Then if you drill down into the detail of the licences, there are different points at least for telling APRA things as opposed to telling ASIC things.

Another area is in the APRA standard conditions of approval which is what the licence is called. The approved trustee cannot carry out any other business, subject to some exceptions, unless APRA approves. So if you have an approved trustee who is also the responsible entity of managed investment schemes that weren't authorised by their licence at the time they got the approved trustee, you then had to seek APRA's approval for carrying on that business even though ASIC will have, if you like, the more logical running of, "Well, do I let them establish this new scheme or not?"

So I suppose if you think about the practicalities of the sort of examples I've been giving, what it means is that IFSA members or anyone who provides superannuation and managed fund products to consumers basically has to run two compliance systems, and some of those compliance systems - I think IFSA agrees - they have to be run because they're the ones dealing with the preservation, the contributions, whatever. That's a necessity because it is a superannuation fund. But where they're not those sort of policy-driven things, there's a lot of commonality but unfortunately slight inconsistency, sometimes larger inconsistency between the equivalent, the same ground, and it's IFSA's submission that that ground could be equalised without detracting from the consumer protection given for consumers.

The IFSA membership, I think, prefer the Managed Investments Act on the basis that they say it's clear and more codified. Certainly I had someone helping me through this who hadn't looked at SIS before and they found it quite hard to navigate around SIS but I think that's because if you look at it, it's dealing with the common ground but then it's interspersed with policy provisions. That's something which, I suppose, from my point of view I know it's uncomfortable with it, but for perhaps some of the smaller players in the market, there is probably a risk that they won't easily find the law that they need to comply with. So there's I think a lot to be said for standardising or having one system of the common things and then it helps focus the mind on what are the real differences.

I think it's important to note that IFSA is not proposing the abolition of SIS. It recognises that where trustees are regulating by SIS but they don't have managed investment schemes, to change the regime for the sake of changing it to make it more consistent may not be preferable. What it is saying is that where companies are providing two sorts of products, there is scope to reduce duplication without reducing investor-checked protection. That's essentially the nub of it but we've left quite a lot of time for questions. I don't know whether you want to follow on, Kerry. What would you like?

MR COSGROVE: By all means, if you have some additional points to make.

MS HOWARD: They're not really, I guess, additional points to the points that Jim has made, they'd be really amplifications in our perspective from - Jim's firm is an

adviser to our firm and a number of firms in the industry. As a former practitioner, a person who worked for a wide range of superannuation funds and now works in a very specialised area, SIS is a piece of legislation that is one size fits all. It really governs your corporate trustee of a small manufacturing company to a public offer fund like us where we have multiples of thousands of investors and multiples of millions of dollars under management and they're quite different entities. If you were looking at them in another situation, you wouldn't compare them. They're quite different.

Where the corporate trustee is doing something that's additional to their normal task, this is our core business. Managing money is our core business and I guess Jim started when he first started about - investors select a company like Merrill Lynch or BT or AMP because of the house and the investment style. They're picking a product. They're saying, "I want Colonial First State Australian equities," or AMP's international shares and this is superannuation money and therefore it goes into the superannuation option as opposed to, "I also have some savings that I have additionally and that might go into that particular fund manager's non-superannuation product." It's almost bye the bye that they pick us because they don't look at it as superannuation governance attributes.

As a house, our core governance practices govern both our superannuation and our non-superannuation assets. Oftentimes - and it's quite common throughout the industry that a superannuation fund will be - the money will - entry point into the - as a superannuation fund but then it's on-invested to a non-superannuation vehicle. For example, it might come into our portfolio as a balanced retail superannuation product. That balanced retail superannuation product invests in a wholesale managed investment scheme that invests offshore in international shares or international bonds, so that there's two levels of governance there. The managed investment scheme has a level of governance in the superannuation fund but fundamentally we apply the same corporate governance practices across the board.

Taking up Jim's point, yes, MIA is codified. It's easy to follow. It's an easy section of the Corporations Law to follow. It follows on sequentially from each section. SIS is difficult to navigate around. If you leave SIS for 12 months and try and go back and work out where various provisions are, it is very difficult to find your way around because of that co-mingling of contributions provisions, payments provisions and governance and disclosure provisions. The custody agreement issue is - for example, we have a domestic custodian that is a domestic custodian across our superannuation assets and our non-superannuation assets but the way we've solved the different requirements is to have two agreements with them, one fundamentally from a commercial perspective; their performance should be judged on their ability to perform their role, do it efficiently with the appropriate levels of controls that should be governed by one structure and one regime.

Because I think of the one-size-fits-all concept within SIS, it's often difficult to determine what differentiates APRA's role, what are they regulating, a corporate trustee versus a public offer trustee where the one size of prudential regulation doesn't fit all, and it's a very difficult line to draw sometimes, and to elicit from them

where the different strikes and regulations should be. That's probably all at a high level, yes.

MR COSGROVE: Good, thank you. Well, I guess one of the central issues which we need to consider gets back to a point that Jim made and that is that you feel the Managed Investment Act contains or provides at least as many assurances for the superannuation fund members as does SIS. Now, you know, I've taken note of the examples you have provided us this morning but we're still hearing, from other participants, doubts as to whether that is the case. There's a lot of store placed by them on the trust structure, the so-called honest, independent, unencumbered representation of fund members' interests, and some uncertainty - it may not be fully informed and that's one of the things I'd like to explore with you - whether or not, in a responsible entity governed by the Managed Investments Act, there would be the same degree of independent representation of members' interests.

I think you told us this morning, Jim, that you see the Managed Investment Act requiring a responsible entity in circumstances where there might be some degree of tension or potential conflict of interest between the company's own financial objectives and the interests of a superannuation fund group of members, to give priority to the interests of the superannuation fund members. Is it as clear-cut as that? I must say I'm at present not very familiar with the Managed Investments Act but I'm asking this, as I say, because we have heard a lot of doubt expressed about whether there is such certainty about the support for the members' interests and - - -

MR BOYNTON: Yes, I can quote it. It's quite short.

MR COSGROVE: Mm'hm.

MR BOYNTON:

> In the exercising of its powers and carrying out its duties, the responsible entity of a registered scheme must act in the best interests of members and if there is a conflict between the members' interests and its own interests, give priority to the members' interests.

I think the "act in the best interest of members" is also in SIS, it doesn't go on, and I think with the independent representation - there are essentially two paths that you can go down in SIS if it's a public offer entity and essentially retail investors. There's no requirement to have equal representation on the trustee board. There's a requirement to have an approved trustee and that meets that. The alternative is where you don't have a public offer fund and equal representation.

MR COSGROVE: Yes. So why is it, do you think, that several other people interested in this inquiry attach such weight to the trustee structure for superannuation purposes? Is it a matter of unfamiliarity with the details of the Managed Investment Act? Are there any other reasons you could think of that lead them to this view? It's been very widespread, I must say. We've been asking the number of people who appeared before us about the proposal you've been putting to

us and almost without exception, I think, we've had a response, "No, superannuation requires a trust structure," and that's only available really under the SIS legislation.

MR BOYNTON: No, I'm not sure why. I think there's a broad range of managed investment schemes and there are agricultural forestry schemes, property-type schemes and - what's the best example - perhaps a film scheme where for tax and other reasons the copyright is held by the investors rather than the responsible entity, and so the scheme property doesn't include the copyright because that's held by the individuals. In most cases you say, "Well, yes, the law says the scheme property must be held on trust," and so the money coming in from the investors and money coming in from the investment is held on trust. So it is possible to, if you like, have a core trust relationship and outside that core, you can have contractual relationships in those different managed investment schemes but I think certainly for the IFSA membership, they're not the sort of schemes that IFSA memberships provide.

They provide, on the whole, the regular investments schemes, different types of financial instruments underlying it and as I say, there are good tax reasons to make that essentially the same, and having prepared trust deeds for superannuation funds and constitutions for managed investment schemes, they are both set up as trusts, they both have very similar provisions in them. They will, of course, have some different provisions because of preservation and things, but they're essentially the same. I think essentially the beauty of the trust for superannuation is that it's principal-based and it's got those core duties I've spoken about. The same is true for the managed investment schemes and maybe it's, as I say, a lack of familiarity with the way these things work.

MS HOWARD: Or perhaps a stronger familiarity with the regime of non-public offer products so that that's nearly every - well, every superannuation arrangement out there is structured as a trust. In my mind there is no distinction between our trusts that are our superannuation funds and our managed investment schemes, which happen to be called "schemes" under the Corporations Law. As Jim has said, if you put two side by side, they would look on the front no different. It's only when you actually get into the superannuation fund it might have some schedules attached to the rear which will contain payment standards. It may have sections within a super fund - your allocated pension and your non-allocated pension sector. So there will be a slightly different variance there but that's getting into the operating standards about contributions and payments and preservation. They would be the differences.

MR COSGROVE: Yes. Now, how would that be handled under your approach? As Jim said, the retirement income's specific elements of SIS are not present.

MS HOWARD: No.

MR COSGROVE: And not intended to be present in the Managed Investments Act. So how do you deal with those under your proposal?

MS HOWARD: They would continue.

MR BOYNTON: They would continue, and IFSA hasn't done the detailed work of working out which sections match but I think - - -

MR COSGROVE: So you would need to amend the Managed Investments Act to incorporate those elements of SIS that are not replicated in MIA?

MR BOYNTON: Or another way to do it would be to say in SIS that if a - I'm trying to think of the terminology here - - -

MR COSGROVE: Say, the alternative is an exemption under SIS?

MR BOYNTON: Yes, if the trustee of a regulated fund complies with the provisions set out in the schedule or all of chapter 5C, then they need not comply with - and then you'd have a list of - - -

MR COSGROVE: These particular parts of SIS. I see.

MR BOYNTON: And it would be a bit more complicated than that because then you'd say, "And the members of the funds have the same rights as they would had they been a member a of managed investment scheme."

MS HOWARD: But the operating payments and the preservation standards and all that, you would still be obliged to comply with them under SIS.

MR COSGROVE: Mm'hm.

MR STANHOPE: IFSA has quite deliberately limited its comments to the approved trustee environment and so the solution that we've suggested on the aide-memoire we've given you is really that where there is duplication and overlap - which is essentially in the improved trustee provisions - that satisfactory regulation under the managed investment scheme should perhaps - the best way to say it would be "regarded as having satisfied this list of corresponding provisions in SIS". The non-corresponding provisions, the tax policy provisions and so forth, we've left aside in any case. They are not really within this reference that you have, so we've not addressed it, nor are we seeking to address the representative trustee spectrum, which is where you are hearing your comments from. IFSA does provide services to those people but these comments are made in respect of the approved trustee, the retail end, if you like, of the market where people are coming in as consumers of one product - local superannuation - or consumers of another product, labelled "managed investment" and we're making a point that there's a consequence of the two different regulatory schemes. We have duplication which could be avoided, which is fairly squarely within the questions raised in your issues paper.

MR COSGROVE: Roger, you might take the point there.

MR FRENEY: Yes, if I may, I'd be grateful. Understanding it correctly, if I think that your proposals would relate to entities that are both responsible entities registered under the Corporations Law and approved trustees - approved under the

SIS - - -

MR STANHOPE: That's correct.

MS HOWARD: Yes.

MR FRENEY: Right, thank you. In your aide-memoire you have referred to this applying to retail clients. Could you just explain to me what you mean by "retail clients" please?

MS HOWARD: The legal definition or - - -

MR BOYNTON: I think there are different definitions of "retail" around. For example, under the Financial Services Reform Bill every superannuation product or every interest in a superannuation fund is "retail." I think the distinction IFSA is trying to draw here though is that to not be a public offer fund means that essentially the members of that fund are employer-sponsored members which in turn means that the general rule is the employer to whom the product is sold rather than the member. So when using "retail" in this context, you're saying the IFSA membership public offer funds are the ones that are sold to consumers directly rather than the non-public offer funds which have that employer link.

MR COSGROVE: So it's essentially public offer funds. For example, if an industry fund was offering public offer arrangements, that would be part of your definition of retail.

MR STANHOPE: We are not necessarily proposing a global or prescriptive solution. We are pointing out an issue that our membership has with the current regulatory structure and not seeking to have that solution necessarily spread wider. There may or may not be good arguments for doing that but we don't represent that sector and we're not seeking to speak on their behalf. What we are simply saying is that there is a reasonably elegant solution, it seems to us, for those funds which might be considered "retail" in the sense of the word of selling directly to consumers, and that's the sense in which that word is used. There's a raft of definitions of what is and isn't "retail" inside the Corporations Law in terms of who's caught by requirements for competency and advisers and the like, but in this case we're using it in a fairly general sense; seeking to find a word that has a meaning about those people who come fairly directly to our investments.

Now, they may be people who come in through advisers, they may be people who come in directly to our members or they may be people who go to their employer or their employer encourages them to make their own choice about what superannuation is and the employer does not sponsor a scheme, so the people who are electing one way or another to use products offered by our membership directly to the public, including through financial advisory and financial planning intermediaries, of course. Where there's an employer or an employer fund or a multi-sector employer fund interposed between the consumer of superannuation and the provider of the investment service, we're not seeking to comment.

MR FRENEY: So under your proposal order, would I be right in thinking that the registered entity or the approved trustee would provide the trusteeship for the superannuation purposes?

MR STANHOPE: And that's why - - -

MR FRENEY: But the person who would be coming in and seeking the service wouldn't be necessarily providing the trusteeship?

MR STANHOPE: No, the trustee would be provided by our members, which is why we've gone into some length to explain to you that we think the provisions are at least equivalent, if not in some cases slightly better.

MR FRENEY: Yes.

MR BOYNTON: Perhaps it would help to say that most financial institutions I know, they have a single company doing both jobs and they have an approved trustee and they have a dealer's licence which authorises them to act as a responsible entity.

MR FRENEY: Right. So in a sense your proposal would be able to eliminate the trustee structure of an approved trustee entity and resort to the responsible entity obligations under the MIA.

MR STANHOPE: No, I think it would be truer to say we would be meeting the requirements of the approved trustee through the responsible entity. The intention here is not so much to replace anything as to avoid - we have essentially two parts to the same destination. What we're seeking to establish with you is that both paths are at least - the MIA path is at least equivalent, and that should we have people who go down that path, it's a duplication to require them to go down the other path as well.

MR BOYNTON: I think for the purposes of SIS the same company would still be the trustee for the purposes of SIS but for the purposes of meeting particular provisions of SIS, they can say, "Well, I've met the equivalent provisions in MIA, so I get a tick for those provisions."

MS HOWARD: Having satisfied the prudential standard under one regime, you would be deemed to satisfy the prudential standards under another regime.

MR COSGROVE: Quite a bit then turns on the actual degree of equivalence as between these overlapping parts of the two acts. Roger, did you want to raise the questions on that?

MR FRENEY: I had a question about that, if I may. I suppose it's been partly answered but my understanding is that under the SIS Act, one of the requirements of trustees is to formulate and give effect to an investment strategy, and yet I'm not sure that that is a requirement under the MIA. Just having received your aide- memoire, I've been trying to think through that under the SIS, this is a relatively, if not very

important, obligation on a trustee on behalf of the members and the investment strategy should be formulated in a way that is consistent with the interests of the members of the superannuation fund and relevantly to the circumstances of the members of the superannuation fund. So there's an actual step here in terms of an entity formulating an investment strategy that is relevant. I'm just trying to think through how, under your proposal, the members - who would be representing the interests of the members in terms of formulating an investment strategy before you get to the element of executing an investment strategy?

MS HOWARD: This gets back I guess to the point I made earlier about SIS being one size fits all. You see how the terminology of setting an investment strategy works so well in an employer fund or a multi-employer fund when you've got - you sit and you've got X number of million dollars under management with different objectives of people and the help of asset consultants and actuaries to formulate an investment strategy and you then go and select various managers as opposed to the product regime we're talking about where the investor has chosen - the consumer has chosen a product. They've chosen the Merrill Lynch balanced superannuation and pension fund. They've chosen the Colonial First State Australian equity superannuation fund. They have actually selected the strategy, they've selected the strategy themselves.

Someone has selected - they may well have been advised in this market. They have chosen Australian equities or balanced or international equities or a Pacific sector fund so that - these provisions actually don't work particularly well with single product offerings. The disclosure of the investment strategy is made in disclosure material and is selected by the investor. So that the investor has bought something as opposed to having something - it's the arguments about choice. Someone selects something, an investment stylist, and they're choosing both a strategy, it might be Australian equities. but then they're making a second choice about a fund manager's particular investment style over and above someone else's style, which differentiates one manager from another.

MR FRENEY: I'll need to think more about this but it seems to me to be a fairly fundamental shift away from the concepts of SIS, but let me just ask you another question, if I might. Does your proposal envisage that a small APRA fund could come to Merrill Lynch and subscribe to a balanced fund under this proposal or are you talking only about a unique individual person who comes and subscribes to your product under your proposal?

MR BOYNTON: I think we have focused on superannuation funds and you have to - basically the members of those are individuals. If a small superannuation fund came to Merrill Lynch or any other IFSA member, you couldn't put them into a super fund. You would either put them into - if they were going into a pool product - a pooled superannuation trust or you would put them into an ordinary money unit trust. But there the trustee of the small fund would be choosing, "Which is the strategy suitable for us?"

Getting back to your question about the investment strategy, if you like, there

isn't the equivalent duty to set that investment strategy under MIA but in SIS it's always been a bit of a tension because of the way these products are developed in that you say, well, this is going to be an Australian equities fund or an option of a super fund come into it, and that's the exposure you would get. The trustee of the fund - in the example we've been giving - under SIS must have regard to the liquidity and the potential liabilities of the fund. The mainstream funds we're talking about are very liquid funds. They will though, for example, normally say, "This is a long-term investment, so three to five years," so that, for example, if someone were to come into it the day before they were about to retire, that may not be the wisest choice for them. But once again, it is the consumer who picks the fund and the funds disclose what the objectives and the strategies are.

I'm not talking about that this is what happens under SIS now and yes, the trustee has to manage it so that it meets the liquidity requirements of people but these funds are, once again, I suppose, fundamentally different to the traditional staff fund where instead of having people leave to get their benefit, these funds, if they don't like the product, they leave. So you've got to allow for quite a lot of liquidity as well. So you're right, there's no equivalent there in the law but the way they are managed and sold almost leads to the same result.

MR FRENEY: Could I just ask you another question in this area to help my thinking. One of the key purposes of SIS - and the investment strategy formulation under SIS - is to provide retirement income ultimately and for that, diversification is a fairly key point, and one of the issues that's been arising in the managed investment sphere can be the narrowness of some of the managed investment schemes. So - just thinking out aloud - would your proposal allow, for example, a superannuation investment to end up in a very concentrated area of investment that may not perhaps be relevant to retirement income? For example, could somebody who's registered under the MIA and also be an approved trustee offer an investment product that wasn't suitable to retirement income purposes?

MR BOYNTON: I think it's worth noting that there are currently superannuation master trusts now under SIS that offer over 100 different investments. Those investments may be direct shares. You can specify the shares and there are some steps taken to allow that diversification. They develop their own rules as to - well, you've got to have at least one managed fund and five lots of shares or whatever, so that is already happening there. It is true that you could have an extremely specialised managed fund and that may not be appropriate for someone's superannuation. Equally it's true that you could offer that as an investment option through a SIS-regulated scheme and get the same result.

MR COSGROVE: Roger will correct me if I'm wrong, but I think what is lying behind his question is that it's one thing, as Kerry was saying, to make a choice that, "I want this product, a Merrill Lynch balanced fund." That is a decision which could be taken on the basis of having seen something on the television - you know, "Merrill Lynch, we're a top performer. Have we got a fund for you," and contrasting that type of decision with what seems to be required under SIS at the moment, namely, that you have to go through a conscious process of determining an investment

strategy with a view to the implications for the development of retirement income streams down the track. Now, that may be drawing the distinction too sharply but is that actually what you're trying to - - -

MR FRENEY: That's the sort of thought I had in mind, yes.

MR BOYNTON: I think - correct me if I'm wrong, Bill - IFSA haven't sort of gone through and said, "Well, that's in, that's out," whether the investment strategy would be one which we would think would be satisfied by MIA or isn't. It's more raising the examples of, well, there are a lot of parallels. If it's something to do with a retirement income policy, you'd probably keep it as an additional - - -

MR COSGROVE: It again gets down to what are the real areas of equivalence between the two pieces of legislation.

MR BOYNTON: Yes.

MR STANHOPE: It might be worth pointing out that there are very different channels for access to these products, generally speaking. I appreciate the concern that individuals may be directly purchasing superannuation, retail superannuation products. However, certainly later on in working life where there's a reasonable accumulation of assets, a large number of people will be using an intermediary of some kind so the locus of the investment strategy decision, if you like, is made largely at the point at which the advice is delivered to the individual or disclosure is made to the individual and at that point they make a choice. There are certainly any number of funds in the various categories on the market right now in which an individual can make pretty much an unfettered choice on the basis that they liked Merrill Lynch or AMP, Henderson or whomever's ad was on the television last night, so you don't necessarily avoid those things currently.

As Jim has pointed out, if they were considered to be critical to retirement income's policy, that might be a different matter. What we're actually trying to take you through here is how things are different in the public offer environment, and one of them is that you have intermediaries largely making those decisions who have obligations to know their client. You might say that those are a raft of similar and sometimes higher obligations than a trustee has in terms of generally making a decision, and it is a shift in model. There is no doubt about it. We're talking about a move from people who have no choice about where they place their money and therefore a lot of reasons for having a trustee choose on their behalf an investment strategy in a raft of things, to people who are making choices.

We're not proposing a one size fits all strategy. That's our difficulty with SIS as it stands. What we are trying to do is to avoid some of the regulatory overload that occurs in the public offer environment. If that needs to be corralled from the sorts of concerns you have, IFSA does not have a problem with it. In fact, we're not trying to suggest a global solution for precisely that reason.

MR FRENEY: I would, if you don't mind spending a little more time on this - I'm

only asking these questions to help my thinking about it because I find it an interesting topic. Perhaps just so we can get on the record whether my understanding is right, I think that the emphasis that you gave, Jim, was that the provisions of the MIA might actually give the members of the superannuation fund greater protective benefits than under SIS. You didn't elaborate cost-saving benefits but you certainly did emphasise, if I remember correctly, the protective elements. Is that right?

MR BOYNTON: That's right. Some of the provisions, as I said, impose higher obligations and have higher sanctions. I don't think IFSA has done the work on the costs of these things as it - - -

MR FRENEY: Right. I mean, one of your thrusts is to avoid duplication which - if I could just check my understanding then with respect to other kinds of superannuation arrangements that your members provide. For example, some of your members would provide master trust arrangements for corporate superannuation so that companies will ask your member to be the trustee of their corporate super fund, and also smaller superannuation funds, do-it-yourself superannuation funds and small APRA funds, I imagine, could also avail themselves of trusteeship arrangements with your members. In those sort of cases - but let me just focus for the moment on the corporate superannuation funds that use a master trust - in those situations your members would still have to comply fully with the SIS arrangements and have SIS compliance arrangements in place.

MR BOYNTON: As it stands now?

MR FRENEY: Yes, and as you're proposing.

MR BOYNTON: Yes, as it stands, yes. As we're proposing, it's something which I have discussed with IFSA. I think a distinction needs to be drawn between where a trustee is provided for the trust as opposed to the corporate fund being part of a greater trust which is essentially the product provider's trust. I say that because the first one probably isn't a public offer entity under SIS; the second one may or may not be under SIS, just because of the way the definitions work and whether that's part of a greater fund which has retail investors in it. I don't think that the IFSA proposal is drilled down into that level of detail. The majority of IFSA members, I would guess, don't provide that first service - - -

MR FRENEY: It would be my impression that your members perhaps do provide both services and I was just trying to think, is there really scope for reducing duplication and cost saving if you're having to live within a SIS framework anyway?

MR BOYNTON: I think there would be, because whether it's a small fund or the biggest fund in the country, you still have those covenants which you must comply with. You still have complaints procedures, examinations and things which are covered by similar but different laws. What we're saying is if, I suppose, an IFSA member were to be a trustee of a small fund - I don't know whether it would have the choice, it's a matter of detail - but if it complied with what we're saying are the equivalent managed funds provisions in relation to that small fund, I think we'd say,

"Well, that's a tick."

MR FRENEY: I can't take this terribly much further but I imagine even there'd be some smaller approved trustee entities that may be or become responsible entities under MIA and that might take in smaller super funds - be the trustee for smaller superannuation funds. So it would be having to comply with a SIS regime. But there may well still be scope for reducing some duplication anyway, which - I suppose that leads on to the question: what would the benefits for the members of the super funds be? You've certainly emphasised the question of greater protection under MIA as you see it. Do you also see potential cost savings being passed on to superannuation consumers?

MS HOWARD: I can't say that there would be a - and each business model is different, is the great difficulty as you've just touched upon. So that for every business model, the way efficiencies translate to lower overall management expense ratios is - I'd be making a very broad brush statement if I just categorically said yes or categorically said no because they will flow through in different ways in different businesses. But certainly if you improve overall efficiencies in your business, over the longer term, your costs will come down. This is one thing that moves towards overall efficiencies in the business.

Just taking up the point that Roger made, I just read an article last night actually about master funds - a bit related to choice - but I think one of the things that this article was alluding to was the different models that will be required as the world moves forward in an e-world, that a superannuation master fund model that might exist today may not be the model that's suitable for - both employers and individuals are looking for service. It was pointing out that the superannuation framework that we have in our minds today that came from a mind-set of 10, 15, 20 years ago is not the model that will necessarily be suitable for tomorrow - not to really provide any answers but it was just a timely observation.

MR STANHOPE: To get directly to Roger's question, the members that I have spoken to have clear examples of duplication in their effort. To provide a cost estimate would require some sort of rigorous survey and as Kerry points out, there are a raft of different business models and locations of compliance and all of those sorts of issues. So no, we have not sought to get down to quantification at that level. That would be a large exercise which we might well undertake if a proposal like this were to get wings, as it were. At this stage we're seeking to establish only that there is some merit, that there is duplication and that there is a clear benefit to be had and that it occurs, as we're arguing, at no cost to superannuation consumers.

MR FRENEY: Would you mind if I just ask one more question, which actually was prompted by another participant whom we are seeing this afternoon. They have commented that if some superannuation suppliers were regulated under the MIA, that there would be a different regulator for some superannuation providers than for others and that that could open up the risk - a sort of supervisory risk, if you will, to use their terminology - that you would have different levels of prudential requirements being applied to different providers of essentially the same product.

Would you have any view about that?

MR BOYNTON: I guess the first observation is that we already have different regulations looking at different parts that was covered by SIS in that we have ASIC, we have APRA, we have the ATO already, and going from one regulator to three, obviously there's more management involved in doing that. As to which regulator would regulate what IFSA proposes - and I don't think IFSA's thinking advanced on that - but if, for example, it were ASIC, it would mean that there would be one regulator for that particular area rather than two and I don't think we're really in a position to say whether there would be a mechanism which you could put in place to say, "If you satisfy MIA then you're taken to satisfy these provisions of SIS," and could say that in the current world APRA is the person for judging whether you had done that or whether you would say APRA would have to be bound by ASIC's policies or whatever.

MR STANHOPE: There are two regulators in the field for superannuation funds at this moment, depending on whether you're a small APRA fund, public offer fund or any of those, or if you are a self-managed superannuation fund. So this proposal doesn't necessarily add anything to that and all of those funds, to the extent that they are corporates, are regulated by ASIC as things stand and to the extent that they make public offerings are regulated in some disclosure aspects and in licensing aspects by APRA as they stand, and FSR may or may not take that further.

MS HOWARD: Some disclosure aspects of super are now covered by ASIC.

MR STANHOPE: They're covered by ASIC as things stand. I mean, APRA doesn't regulate disclosure, the disclosure provisions. So it's not a problem - - -

MR FRENEY: I understand that, but there seems to be an attempt at separation of regulatory function under FSR between ASIC and APRA, whereas I think that the implication in this is that approved trustees - who are also responsible entities registered under the Corporations Law under your proposal - more of their operations, if not all of their operations would be regulated by ASIC. So that you would have APRA regulating quite a lot of the same provisions or very, very similar provisions of SIS, and ASIC regulating almost the same provisions of MIA Corp Law, and so you would have greater opportunity or possibility of regulatory difference coming in.

MR COSGROVE: And as a result you might have what they call in the jargon "regulatory arbitrage", so that some funds might decide, "Well, I'd rather be regulated by this regulator than that one." Obviously there can be inefficiencies in that and potentially some risk to fund members. I think it's a bit of a quantum difference from what presently prevails under the SIS legislation.

MR BOYNTON: I think I'd say to that, if you look at the differences between public offer and non-public offer, you do have quite different management structures. You have an equal representation management structure compared to, like, a professional trustee management structure, and you'd have products that are sold on a

different basis, and maybe there is merit to say where the products are very much like the managed investment schemes, ASIC should - I don't care which regulator - a regulator should have carriage of both those things because there's more likeness there than there is there. Yes, they're the same provisions but maybe there should be a refocus.

MR COSGROVE: All right. That's an issue. We've been talking a lot about these potential costs of duplication across a couple of pieces of legislation. We are also expected in the course of this inquiry to form a view on whether or not the SIS Act has any anticompetitive effects. Do you have any remarks on that aspect at all?

MR STANHOPE: We have not considered them formally at this stage and we may do some in our submission. Again we are focusing essentially on how they impact upon us.

MR COSGROVE: That was another question I was going to ask. You do plan to present a written submission?

MR STANHOPE: We do indeed.

MR COSGROVE: Good. We look forward to that and that might address other aspects of the legislation under review, I would imagine, as well as the specific point you have been drawing to our attention today.

MR STANHOPE: We have chosen a deliberate focus.

MR COSGROVE: Yes, that's fine.

MR STANHOPE: The question in terms of drafting the submission, whether we put other material in, we have contemplated issues of anticompetitive provisions, whether or not approved trustee rules are barriers to entry or are they not, those sorts of things. If there's an argument there, we will put it in our submission.

MR COSGROVE: Thank you.

MR FRENEY: **T**hank you for the discussion.

MR COSGROVE: Yes, a very interesting discussion.

MR FRENEY: It's been very enlightening. Thank you.

MR COSGROVE: I think that's it. Thanks very much for coming along. We will have a break for lunch now and we are resuming at 2 pm.

(Luncheon adjournment)

MR COSGROVE: Our next participant is Finlaysons. Mark, for the transcript we'd like you to identify yourself and the capacity in which you're appearing today.

MR HANCOCK: Yes, certainly. My name is Mark Hancock, and I'm a solicitor and superannuation adviser to Finlaysons.

MR COSGROVE: Thank you, and thanks for the submission.

MR HANCOCK: That's all right, my pleasure.

MR COSGROVE: We've had a chance to read it, but are there any points you wanted to make?

MR HANCOCK: First of all, I'd like to thank the commission for the opportunity to present an oral submission today. I don't intend to go over the submission, unless of course there are any questions or any points of clarification that we need to go through. I would like to provide some further comments relating to the terms of reference and to provide just a few comments on some of the other submissions that you've received - comments in support, I might add, at this stage - and certainly I sort of thought that you may also like to ask me some questions, given my experience in developing the legislation in the first place.

In relation to some of the other submissions calling for greater disclosure of information to members, I believe that relevant disclosure is very important. In fact in drafting the disclosure regulations, I recall the Australia government actuary at the time, Donald Duval, saying that sunlight was the best form of disinfectant, and that was certainly his view in relation to providing as much relevant disclosure to members as possible. You must always sort of weigh the disclosure requirements up with first of all whether members can understand the disclosure that's being required, and secondly, so that you don't produce a document that is just so comprehensive that nobody will ever read it, even if they could understand it, and I think that is always the constant battle with disclosure to members. But certainly in relation to some of the submissions that suggested greater transparency of disclosure of administration fees and charges, we would certainly support that. It's very difficult in the superannuation industry at times for members to adequately compare the performance of their fund with other funds, because of - it's an old cliche, but they're not always comparing apples with apples.

In relation to submissions about the effectiveness of the equal representation structure and the trustee structure, while we've said this in our submission - and I promised you I wouldn't go over our submission - we would like to show our support for what we believe is very strong support for the trustee structure. We think it is working very well, and equally for the equal rep requirements. I am aware that the regulator has been talking internally about the possibility of a licensing regime. For a couple of years now, it's been tossed around as a policy concept. I must admit I've never been particularly comfortable with that concept, and I'd like to point to some of the problems that APRA and previously the ISC identified in superannuation to just reinforce that the overwhelming majority of problems that were discovered tended to

be not related to any deficiency of trustees' information or training, qualifications or experience.

A number of people have pointed to the Commercial Nominees case, which was of course an approved trustee, and the problems that occurred there - very difficult to avoid pointing to HIH, with the professional board there as well. I think the only potential difficulty that has been identified with equal rep at the trustee board level is the potential for a dominant personality to take charge, but I think what counterbalances that potential are the investment restrictions that are now in place, particularly in relation to in-house assets and related entities. Certainly in the UK with the Maxwell example, while there was a dominant personality there, most of the money was lost because of investments in related parties and the investment activities of the employer. So certainly there's no getting away from the fact that the SIS legislation was partly due to the Maxwell catastrophe in the UK, in response to that, to try and ensure that it didn't happen here, and as far as I'm aware, while there have been some instances of dominant - well, yes, I suppose you could say dominant - personalities involved in trustee boards, those issues, when they have been identified by the ISC and APRA, have all been worked through with the relevant trustee board, and in some cases the dominant personality has in fact stepped down from the trustee board. So yes, that's what I'd like to say about that.

I'd also like to reinforce what's been alluded to in a couple of the other submissions about the potential conflict of interest for public offer trustees, or as they are sometimes referred to as, for-profit funds. Between the fiduciary obligations that the trustees hold in relation to the members, compared to the obligations that they hold as directors of companies - and sometimes they are public companies - in relation to maximising the return for shareholders, that's an issue that has bothered me for many years. I think the commercial reality is that most directors of public offer funds or for-profit funds adequately work their way through those potentially conflicting duties. However, I think that the regulator should always be aware of that potential conflict of duties and should, as part of their review process, identify that as something that should be addressed on a regular basis.

MR COSGROVE: Mark, on that very point, prior to lunch we had a presentation from IFSA, and the essence of their presentation today was that there's a good deal of overlap and perhaps duplication between the Managed Investments Act and the SIS Act, and that from the perspective of their members, it would be good if that duplication or overlap could be removed.

MR HANCOCK: Sure.

MR COSGROVE: Now, we don't yet have a submission from them, but they have promised us one. If you have the inclination, given your obvious interest in this matter, to have a look at that one and provide us with any reactions, we'd be very grateful.

MR HANCOCK: Certainly. I think while I have come out strongly in support of the trustee structure for superannuation, I think it is possible to mount an argument

that it wouldn't be catastrophic if the trustee structure were to be removed in public offer super funds. I think it would be catastrophic if it were to be removed for corporate funds and other not-for-profit funds. That was pretty much largely what I wanted to say, so I'd like to throw it open to questions.

MR COSGROVE: That's fine. Yes, there are a few points in your submission that I wanted to ask you about, and I'm sure Roger will have some questions as well. Just a factual question to start with, Mark, I was interested to see the mention early on in your submission about the establishment of the national superannuation fund matching service. Now, I realise that occurred only a few months ago.

MR HANCOCK: Only very recently, yes.

MR COSGROVE: So not much happening yet, or is there?

MR HANCOCK: We certainly received some publicity in super funds magazine and super review magazines, and that did generate a reasonable number of inquiries from around Australia. When we came up with the idea, we believed that it would offer an opportunity for corporate funds that were thinking of their future and what they needed to do, whether they should continue as a corporate fund or whether they should, like a significant number of other corporate funds, wind up and transfer over into a master trust or industry fund. We believe that there is a third way, so to speak, and that is that it is possible for a number of corporate funds to amalgamate, to maintain the equal rep structure, to attain those economies of scale that they felt that they were currently lacking. A choice of super fund is very much on their mind. They believe that if choice comes in, they would need to be able to provide members with similar services to some of the other funds if they wanted to continue to provide that. A large number believe that it really is an economies of scale issue. We didn't know how much interest we would receive because it hadn't been discussed in any great detail. It had been mentioned a couple of times around the place, but nobody had ever really focused on it.

To our surprise, we probably received more interest from small industry funds, looking at their future, and we've spent a fair amount of time talking to some small industry funds as to whether amalgamation really is an appropriate mechanism for them to achieve what they want, and what they want is growth. What they also tend to want is to maintain their identity, and of course the amalgamation process, by its very nature, particularly if there are two relatively equal parties coming to the amalgamation, would mean that a new fund would be created rather than just another fund growing. So we've actually got to the point with a couple of them that they need to consider in greater detail how they intend to grow. What they found is that while there are significant numbers of corporate funds winding up and transferring into master trusts, it is extremely difficult for industry funds to even be put on the table by those that are advising corporate funds as to what the options are. In some cases a tender manager will be appointed to handle the process of picking a master trust.

In some cases industry funds are not even identified as a possible alternative to

the transfer to a master trust. It is rarely an open tender process that occurs. What the normal practice is that four, five or six master trusts will be asked to express an interest in the business, and then written submissions are made against selection criteria, some form of assessment process and rating occurs, and then through a short-listing process, the master trusts are invited in to the trustee board to provide an oral submission. The industry funds, as I said, are often not even offered as an alternative. If they are, it tends to be the larger industry funds that are offered as an alternative, so a number of the smaller industry funds are saying, "How do we get a guernsey in this? How do we even get to the table?"

MR FRENEY: From our point of view, Mark, in terms of whether the SIS Act has any bearing on competition, I was interested in what you were saying. I understand from what you were saying that SIS would allow amalgamations. SIS doesn't - - -

MR HANCOCK: It certainly doesn't preclude - - -

MR FRENEY: - - - act as an impediment against amalgamations at one point.

MR HANCOCK: No.

MR FRENEY: The second one was, from that process you were just describing of the industry funds being considered by corporate funds as an alternative, SIS wouldn't be having any particular influence, detrimental influence on that.

MR HANCOCK: No, there probably is - - -

MR HANCOCK: Does it address those sort of competition angles of SIS?

MR HANCOCK: There is a specific issue in SIS that I haven't addressed in the submission but I should probably mention now. When corporate funds do decide to wind up and transfer over, the majority of these transfers are done under the successor fund provisions. There is a reasonable amount of discussion amongst the legal profession as to exactly what that means, what equivalent rights are. Certainly APRA has issued a circular recently which has gone some way to addressing those concerns, but I think if those provisions were to be clarified in the legislation as to exactly what it is that a fund, the trustees need to consider and take into account for the successor fund provisions to work, that would be helpful.

The other point that I should make as far as SIS impacting on the decision is that SIS focuses on the trustees and their responsibilities. Certainly the successor fund provisions, the trustees must reach a decision as to whether equivalent rights are being provided. Often the decision to wind up the corporate fund is taken by the employer. It is the employer that decides to withdraw support for the corporate fund. Then our advice is that the employer should work with the trustee board to explain to the trustees why support for the corporate fund is being withdrawn. Usually there's costs involved, and not only in money, but in time. I don't think, and I mentioned this in the paper, that I can directly point to parts of the SIS legislation that are responsible for this rationalisation of corporate funds. I think it's a combination of

things, and I've put in some anecdotal evidence there from some of our clients to point in those sorts of directions.

I suppose to answer your question, Roger, no, I don't think there is anything that can clearly be identified in SIS as being anticompetitive in that regard. It's more market forces taking charge here, and certainly the market forces argument is that the big players, the big master trusts and the large industry funds have the reputation in the marketplace that they can go out there and they can present to the trustee boards, and people have heard of the organisation that they're representing, whereas the smaller master trusts - and there are a number of smaller master trusts - they also have difficulty getting their product presented before the board.

MR COSGROVE: Is there much scope for amalgamation between small corporate funds? Would they not tend naturally to look to a master trust type arrangement or perhaps an industry fund?

MR HANCOCK: Yes, I agree. Certainly I didn't expect the very small corporate funds to be interested in amalgamation. The types of funds that I thought may be would probably be those corporate funds with $50 million or greater, looking to go that next level.

MR COSGROVE: Mark, you presented a table drawn from APRA information in your submission. While we're familiar with at least some of the results shown in that table, the one that I hadn't really expected was the significant decline in the number of retail funds. Perhaps this is a question we should address to APRA rather than you.

MR HANCOCK: It certainly is. The thought that occurred to me was that it's possibly a definitional issue and in putting that table together I used another of the former ISC statistical bulletins and APRA publications and particularly the 1995 figures tended to vary as the years went by. I think that was as the data was cleansed, for want of a better term, much like the ABS will come out and revise their figures either up or down. I think the statistics area did the same thing.

MR COSGROVE: There might have been some amalgamation or consolidation of funds occurring within the retail sector, I guess, but - - -

MR HANCOCK: There's probably a number of issues there. It's pure speculation on my part, I'm afraid, but there have been a number of amalgamations within the retail fund area where companies have amalgamated to form larger companies but also the number of funds on offer. I think just as we saw some of the larger employers get to the early to mid-90s with in some cases 18, 25 various super funds through various acquisitions, company acquisitions, over the previous 10 or 15 years, and they went through a rationalisation process - just to give one example, the ANZ Bank. Speaking to people there, they have spent a lot of time over the last few years bringing down the number of funds - corporate funds, company funds - that the ANZ Bank had and I think they started with about 18 or 20 or so and I think they're down to about two or three.

MR COSGROVE: Just below the table, you're citing the views of some of your clients. One had said:

> With choice of fund coming up, we don't think we can compete with the additional benefits being offered by the larger funds.

I would be interested to know if you could tell us what these funds are. Are they larger corporates or are they industry funds or large retail funds?

MR HANCOCK: As in the fund that made the comment or the funds that are providing those additional benefits?

MR COSGROVE: Yes.

MR HANCOCK: The provision of additional benefits is interesting as well because for a number of years funds felt constrained by the sole purpose test as to exactly what types of benefits that they could offer. Then through a process of evolution and going to either the ISC or APRA, they have received approval or at least a recognition from the regulator that the provision of a certain benefit would not breach the sole purpose test, and I'm thinking of member home loans that are offered by a number of the industry funds. There are additional benefits that are starting to appear by some of the larger financial service providers. In fact it's moving from member home loans to member business loans - cheaper business loans becoming available - those sorts of additional benefits. There usually needs to be some sort of a relationship between the fund and a provider of other financial services. Some of the industry funds have started offering Coles Myer shareholder discount cards to members which is an interesting development.

I saw in one of the submissions - and I'd better not say which one because I'll probably get it wrong - they talked about the sole purpose test and how it's not as crucial as it once was and I agree. I think the thin edge of the wedge for the sole purpose test was spouse contributions. There's no employment nexus for spouse contributions but there are for other contributions. That doesn't seem to make any sense at all. As these additional benefits start to be offered the real conundrum for the government is, "Well, superannuation is concessionally taxed," so if we're going to give that tax concession there should be some limits on what can be done with that money. So I understand the problem, I just think the market is moving towards a solution before the government is getting there.

MR COSGROVE: There's no implication here that SIS itself is somehow or other disadvantaging smaller superannuation funds, is there? It's more a question of a general economy of scale advantages or maybe also, as some of your other clients said, significant tax compliance problems which are - - -

MR HANCOCK: I think the really interesting aspect of that question is that just as some of the very large funds developed the concept of an additional benefit being provided to members and took that concept to the regulator, equally it was always

open to the smaller corporate funds to do that. But first of all, they don't have the resources to do it. They're not always focused on superannuation, so the chances of an idea like that coming from a smaller player is fairly remote. So that's not a - - -

MR COSGROVE: That's not a legislative issue, no.

MR HANCOCK: No.

MR FRENEY: Could I just ask Mark, John, in the next dot point you refer to a trustee feeling pressured about the rates of return. We were just wondering whether SIS imparts any bias or undue concern towards lower risk and whether that could be said to be a legislative bias. There's been a lot of discussion about it around the traps in the industry and there were phases when there was suggestions of legislative influence towards conservatism by trustees, although I think that's tended to have been pooh-poohed a bit in recent times. But have you got any feeling about that?

MR HANCOCK: Yes, I do. I have feelings on most things related to super. I think SIS is fairly neutral when it comes to biases in relation to investment decisions. It's a very broad-brush approach. It basically leads the investment decisions up to the trustees but it requires an investment strategy to be developed and be complied with by the trustees. So it's really saying to the trustees, "You're responsible for this money, you have obligations to members. You need to develop an investment strategy and act in the best interests of members." I've also read an article that has said, "On average, investment returns for defined benefit funds are 1 per cent per annum higher than accumulation funds because the investment mix is different." The first time I heard that I thought, "What a load of rubbish."

MR FRENEY: To make it a bit easier to hit the defined benefit they're prepared to go for a slightly higher-risk profile to make it easier - -

MR HANCOCK: Exactly. That was certainly the argument that was put and has been put not only verbally to me in the past but in writing as well, fairly recently. It does surprise me because I think the trustees of defined benefit funds and trustees of accumulation funds overall are probably receiving the same type of investment advice from their investment managers. So I was really intrigued at the comment. I'd really like to see some statistical data to back that one up, but I don't think there are any legislative impediments in SIS or even influences. I think the real influence on reduced risk is the short-termism adopted by not only members but investment managers and trustees.

They all know that it's a long-term investment but they focus on investment returns, sometimes on a month-to-month basis, if not quarterly. So I think that's the real problem. The only possible way that could come out of SIS is in the member reporting requirements if there is potentially something in that member reporting that is failing to - or is requiring disclosure that focuses on short-termism. I don't think there is because there is a requirement to quote returns over a five-year period.

MR FRENEY: That's fine, thank you. I was interested, Mark, to read in your

submission about the provisions relating to the approval terms and conditions for approved trustee applicants. We've noted what you've said in there. I don't know if there's anything that you would like to emphasise or elaborate. I suppose my thinking on it, just to give you something to react to, is that whatever the legal niceties of it are, for want of a better word, the issue is that as well as having a strong custodian for an approved trustee, there are other obligations on the approved trustee than holding assets securely, and that would want you as a subscribing member into an approved trustee to have that approved trustee relatively strong and able to perform its other duties. So from an APRA perspective I can see that they would want to have some tangible asset or other financial requirement for an approved trustee.

By comparison with a corporate fund you might think that a corporate fund already has a sort of a infrastructure in place. It's got a financial manager, it's got a computer system, it's got an accountant, it's got that sort of facility in there, so you can argue that a newcomer into the game - being an approved trustee - is starting from scratch and maybe doesn't have anything, so that you would want to have an approved trustee as an entity that has some substance to it and is not just a $2 company. So in my mind that was the sort of rationalisation I thought about when I read your submission.

MR HANCOCK: Absolutely. This hasn't come from nowhere. I've had these discussions previously with other people. Certainly the argument that is often put forward is that the regulator needs to be able to clearly identify the approved trustee as a company of some substance so that it's not a fly-by-night operation and I think that is of genuine concern. The question really becomes whether - because we're not talking about capital adequacy ratios like we do with other financial service providers and because an approved trustee can be a very good trustee and perform their duties in accordance with the law without having a computer system and without having infrastructure, because most of those functions - all of the functions of physically running the fund can and usually are outsourced.

So the four people in this room could, as approved trustees, take over a current fund and have the administration outsourced to one of the administrators; the custodian has control of all the assets; the investment managers undertake all the investment decisions. So the administrator not only keeps track of all member balances but also provides member reporting and all the other compliance issues. The trustee board - the four of us, whoever we are - must manage that process and we are responsible for ensuring that it is all done properly, but we don't need assets to do that.

MR FRENEY: We have to have the wherewithal to pay - - -

MR HANCOCK: Exactly. Absolutely.

MR FRENEY: Outsourced for one thing - - -

MR HANCOCK: The members pay.

MR FRENEY: Yes, but we are the responsible entity - - -

MR HANCOCK: That's right.

MR FRENEY: - - - and we have to be able to keep this fund running at the end of the day no matter what might happen. So that if you run into some calamitous situation that mightn't immediately be covered by insurance or indemnity arrangements or replacement arrangements, then the approved trustee has the responsibility for keeping the show ticking hour by hour and day by day, and one of the problems can be that if you don't have the wherewithal to do that, you get in one unholy mess.

MR HANCOCK: Exactly, and we have seen that happen in the past, Roger. We've seen approved trustees get into trouble but the reason they got into trouble was because they were doing the administration themselves and their computer systems weren't up to the task, and they needed additional funds to upgrade their computer systems. However, it is open for an approved trustee to be managed by Mercers, to have their fund administration done by Mercers. Mercer's computer systems are not likely to fail. They have proper redundancy provisions in place. They are adequately resourced and financed to the point that the regulator does have confidence in the administration that is undertaken by the very large fund administrators.

So the point I'm trying to make is that if you're looking for expertise and experience - and I think the regulator should look at expertise and experience in relation to approved trustees - while there are net tangible asset requirements in the legislation, first of all, I don't think the regulator has the power to pluck a figure out of the air and impose it upon approved trustees anyway, given that that issue was already dealt with the legislation; and secondly, even if they do have the power to do so, I can't see the nexus between the requirement for an NTA and an approved trustee that is outsourcing the administration of the fund. I can see the requirement where they're trying to do things themselves and whether they have the capacity to do that but there are trustees out there that do outsource all the labour-intensive functions that they are responsible for and they do it very successfully.

MR FRENEY: We've received your submission on that point, so it's on the record but I can't resist saying that if I were shopping around as a potential member - - -

MR HANCOCK: Exactly.

MR FRENEY: - - - and I was thinking of putting some money into an approved trustee entity of a public offer fund, I would be a bit loath to put it into a $2 shelf company that wouldn't have some wherewithal to be responsible for keeping the superannuation fund running, and I can think of a lot of cash flow requirements that they would have to have.

MR HANCOCK: Yes.

MR FRENEY: But maybe we've taken this as far as we can.

MR HANCOCK: The other thing, Roger, is that there is a difference between starting a fund up from scratch and taking over an ongoing fund because approved trustees - one option for corporate funds is to keep the corporate fund going but outsource the trustee functioning and bringing in an approved trustee. I would argue that an approved trustee that's coming into an ongoing fund with 20 or 30 or 40 million dollars, that has already outsourced its fund administration and investments and all the rest of it, doesn't need 100,000 NTAs to be able to continue to do the role that the corporate trustee was already doing.

MR COSGROVE: On the next page, Mark, you address the question of the complexity or prescriptiveness of the legislation and that's an issue that we have to have a look at, of course. You say, yes, it is too prescriptive and necessarily complex and it can be simplified significantly, and you cite one and probably two - in fact perhaps three instances, all of which sadly are outside our terms of reference, the in-house asset rules and tax matters and disclosure issues. I wondered whether you had any other elements of the SIS Act that you thought were imposing undue compliance costs or whether they're pretty much as they should be from that point of view.

MR HANCOCK: One of the reasons that I didn't provide a lot of detail here is because I'm actually quite sceptical that it is ever possible to achieve simplification. Having been involved in the legislative development process myself, first of all, whenever you try to do it you are criticised, and let me give just one very simple example. The regulations for approved deposit funds under OSSA were very prescriptive and when we were bringing those requirements through to SIS, we left out a couple of those very prescriptive requirements in an attempt to, in at least some way, simplify the requirements, and one of the things we left off was - under OSSA, approved deposit funds were required to maintain the name and address of all members. Now, we didn't include that and the comment we got was, "Approved deposit funds don't need to keep the name and address of all members," to which we say, "Well, of course they do. You won't be able to comply with the other requirements," so we felt there was no need to prescribe it. But there was a real concern that we were moving things in a direction that people didn't want to go to. So simplification is always difficult to achieve and tax simplification is the best example.

MR COSGROVE: Yes, you have said that the legislation - I guess this statement about "simplified significantly" does refer specifically to the matters you have cited.

MR HANCOCK: Yes.

MR COSGROVE: And not really to anything else.

MR HANCOCK: I didn't spend a lot of time on it, no. You probably could go through the whole of the SIS Act and regs and identify different areas but I think

that's somebody else's job.

MR COSGROVE: Okay, I understand. Further down that page you touch on the question of a licensing regime for trustees and you see no need for that in the case of the corporate fund trustees. Again, this is an issue that's pretty much outside our terms of reference but we have the FSR Bill indicating a different means of licensing trustees, and again, from the point of view of trying to avoid unnecessary overlaps, have you given any thought to that?

MR HANCOCK: I have, and I suppose I'd like to start off with a fairly broad statement. I must admit I am beginning to tire from the assumption that all financial service products can be covered by a one-size-fits-all legislative requirement. I think it fails to identify the differences within the various sectors. I was critical when there was a move to provide identical prudential standards across the various entities, including superannuation, life insurance and general insurance, purely because superannuation is such a unique product. Super funds cannot borrow. The overwhelming majority of prudential concerns for other financial service providers is directly related as to whether those borrowings are being kept under control and there is sufficient capital to keep going, and all the rest of it.

Super funds can't borrow. What they can do is lose money through poor investments and lose money through fraud but that's the only way they can lose money, and so you do start to question whether this one size fits all is ever really suitable for superannuation given how different it is from other segments of the market. The Financial Sector Reform Bill, I must admit I went to print it up and then I realised it was 550 pages long. So I decided to save a ream of paper. It is unbelievably complex. I don't think that legislation that is that long can simplify things. I think it is only complicating matters even more.

MR FRENEY: I want to just very quickly, Mark - I notice you report here that some concerns have been expressed about policy committees and people advocate the elimination of policy committees as a cost-saving device and to improve the cost benefit analysis of the act.

MR HANCOCK: Yes.

MR FRENEY: A lot of people have said that. I just wonder, if you were a member of a corporate fund that was run by a master trust and imagine for a moment you had a balance growing up through the $100,000 mark or something in that fund, how would you feel about there not being a policy committee?

MR HANCOCK: I personally would be concerned, but if I could also broaden that out to my experience with corporate funds considering submissions by master trusts; the trustees were very interested in the level of support the potential master trusts provided to policy committees. Some public offer funds support their policy committees to a greater extent than others and I think some policy committees wither and die because of lack of care and attention rather than a lack of interest. So I believe it is possible for some public offer funds to comply with the legislative

requirements but still act in a way that doesn't encourage the policy committee to get excited about what it is that they have to do.

MR FRENEY: I understand that it doesn't have any formal powers.

MR HANCOCK: Yes.

MR FRENEY: But I think that there is a balance as to whether it doesn't provide a communication channel between members - - -

MR HANCOCK: Yes, exactly.

MR FRENEY: - - - and trustees which otherwise wouldn't be there.

MR HANCOCK: Yes.

MR FRENEY: I'm wondering what the value is of that communication channel as part of a prudent protective framework. I think what you would be saying is that perhaps it can be effective if it's nurtured.

MR HANCOCK: Exactly. When we drafted the policy committee requirements - because they weren't a requirement under OSSA, it was a new concept - there was a lot of discussion and debate about how successful they would be given their limited powers - well, no powers - and we were all quite hopeful that they would form or provide a valuable service to members in that as a conduit between the trustees and the members of that employer. As I said, some policy committees work very well and in fact I remember talking to a compliance officer from a reasonably large insurer in about 95 or 96 and he said to me when he first saw the policy committee requirements he thought, "What a lot of rubbish, this wouldn't even work," but he told me that he had now swung around to the point of thinking that they are a good idea and they do provide that conduit between the trustees and the members, and he said that his policy committees were working very well, and I said, "Well, that's interesting because other people are telling me that they don't work very well."
So I think members need to have some say or have the ability to have some say over the actions of the trustees in public offer super funds. Now, whether the policy committee provides that or whether there's even a need to provide members with the opportunity to remove the trustee is another option.

MR FRENEY: Thank you.

MR COSGROVE: Well, the tail end of your submission is perhaps the one with the bite in it.

MR HANCOCK: We'll save the best till last.

MR COSGROVE: It seems there that you might have identified a restriction in the legislation but before we could reach such a conclusion, why is it that lawyers should be doing compliance audits, and I understand you're not making a bid to do financial

audits.

MR HANCOCK: Not at all.

MR COSGROVE: When we raised your suggestion with some other participants, their response was, "Quite a bit of the compliance audit work is of a financial nature and requires the sorts of financial skills that auditors have." Now, I can't remember the particular instances of financial expertise that they felt were required in the compliance audit but you might like to look at the transcript. I've forgotten whether it was Sydney - I think it was probably a Sydney transcript.

MR HANCOCK: Okay, yes.

MR COSGROVE: But yes, what is it that lawyers have that makes them suitable for this type of work?

MR HANCOCK: Okay. Let me start off by saying that I actually have performed audit work myself, not as a solicitor but assisting an accounting firm doing audits. Because I'm not an accountant, I certainly didn't sign off on the audit, the partner did. So I do have experience in doing not only the compliance audits but the financial audit as well, and I believe that there would be very few areas of the compliance audit that are directly related to the financial audit. Significant amounts of compliance audit requires looking at member disclosure issues, looking at risk management statements. Just because risk management statements relate to an investment, it doesn't follow that that automatically relates to the financials of the fund.

Certainly lawyers are trained in compliance areas. We certainly provide compliance advice, compliance manuals for our corporate clients in relation to the Corporations Law in relation to other pieces of legislation. There is no reason why SIS should be any different. It is legislative compliance that we are looking at. I think the accountants could also say that some of the compliance issues directly relate to actuarial requirements, and yet they're not suggesting that an actuary should do that part of the compliance audit, so I don't think just because a part of the compliance audit relates to the activities of another profession that it isn't open for other professions to undertake that work.

I can also give an indication as to why I think that the legal profession has been left out of this, and that is that in the first year of operation, SIS only required a financial audit, and didn't require a compliance audit. The approved auditor was a requirement there, and the approved auditor was an accountant, and the only requirement was a financial audit. By the time the compliance audit was introduced, I don't think anybody raised the issue of amending the definition to include the legal profession. I've never heard anybody raise it before.

MR COSGROVE: So effectively, you do see it as a restriction on open competition in the provision of the service - - -

MR HANCOCK: I think it’s an area that I could do more in. I’ve done it before, but always having to have it signed off by an accountant.

MR COSGROVE: Is it particularly burdensome, Mark, for somebody such as yourself to obtain the auditor’s certificates or whatever it is that enables you to become an approved auditor in APRA’s eyes? Does that require three years’ tuition, or - - -

MR HANCOCK: Certainly most of the requirements relate to membership of accounting bodies, and I have run a number of them, and they’ve all sort of said, "Well, you need to have an accounting degree to join." So that’s the main restriction, and I think the only possible exception is the registered company auditor, and while I haven’t specifically looked at that requirement, I’m assuming that there’s some sort of accounting qualification required there as well. So if we focus purely on the compliance audit, I see no reason why it should be restricted to the accounting profession.

MR COSGROVE: I think that pretty well completes the list of questions we have. Thanks, Mark.

MR HANCOCK: Good, thank you.

MR COSGROVE: As I say, if you’re interested in looking at that IFSA submission when it eventually comes, we’d be glad to have any reactions.

MR HANCOCK: Absolutely, yes, and we look forward to APRA’s submission as well.

MR COSGROVE: Yes, we are. Thanks very much for your contribution.

MR HANCOCK: Thank you.

MR COSGROVE: Just for our transcript, Susan, we need to have you identify yourself in the capacity in which you are appearing before us today, but before you do so, I should mention that as our final participant in these hearings, we have the Australian Institute of Superannuation Trustees.

MS RYAN: I'm Susan Ryan, and I'm the president of the Australian Institute of Superannuation Trustees and it is in that capacity that I'm appearing before the commission.

MR COSGROVE: Thank you, and thank you for the submission that you've given us and some follow-up material that we received yesterday. Is there something you'd like to say at the beginning, Susan?

MS RYAN: Yes, we welcome the fact that the Productivity Commission has undertaken this review of the legislation. I suppose we feel somewhat restricted in what we can offer to you because the big issue in terms of duplication in administrative costs for us is the complex taxation regime, and that is not a part of your inquiry.

MR COSGROVE: No, I'm afraid not.

MS RYAN: So we understand that, and therefore we've focused on the things we thought might be of use to you. In general, our answer to your question, "Is there an alternative regulatory structure that would be better?" our answer is no. We support the current prudential regulatory regime. In particular we believe that the structure of the not-for-profit super funds, with equal representation of employers and employees, two-thirds majority required for any decision, has proved to be a very sound way of ensuring the safety of the funds. It produces, I suppose, a rather conservative approach to investment, but in this particular area, I think that that's not a bad thing. So our support is of the present system, and because we're having this discussion in a climate affected by the collapse of HIH, we certainly would not support a move towards self-regulation. Superannuation needs to be regulated in great detail in the way that SIS and company legislation requires because it is other people's money. Because of the huge social objective of mandating retirement savings and not guaranteeing any particular outcome, certainly with the accumulation funds, which is where most members are these days, we believe that a high level of regulation is justified.

Now, of course there are cost factors there, and of course we would welcome any change which simplified regulation, but we would not welcome any change which created insecurity for the funds. So I suppose it's a fairly status quo sort of position. There were a couple of changes we thought we would support. The chartered accountants have proposed some changes in relation to RBLs and age-related regulation, and we agree with them that once you have the RBL restriction in place, you don't really need all of the other age-related regulations. We would particularly like to see any regulations relating to the 65 to 70 year olds removed, because in our view, with the ageing population, if people are able to stay in the workforce and contribute to their super funds till 70, that has to be a good

outcome for public policy and for the individual.

MR COSGROVE: Beyond 70, would you do the same?

MS RYAN: Speaking for ourselves - we haven't discussed this at our board - I would say yes. I think the test would be if you're in the workforce - if you're earning, rather. If you're in the workforce or you're earning through consultancies or you're hired by organisations to do things and you have an income that can have a superannuation contribution, why not? The more people who are able to earn past 70, I think the healthier our national economy is.

MR COSGROVE: I guess some might have some worries about possible revenue loss implications through estate planning, as they say, with elderly people who really have little need for very much more superannuation, being able to pass on the tax-protected investment to their dependants.

MS RYAN: I suppose you'd have to do a cost-benefit analysis in terms of the effect on public revenue, thinking in terms of the many people in the workforce who will not have achieved at 65 a very high retirement income. I was thinking more of that bulk of the workforce, rather than the particularly fortunate ones who might have been CEOs of insurance companies or something like that, so we would support those changes.

MR FRENEY: Could I just ask while we're in this area, Susan, not thinking so much about the age limitations but the employment nexus, some people have suggested to us or asked the question indeed why is there an employment nexus? They've pointed to the fact that spouse contributions, for example, have driven a pretty big wedge into the concept of employment nexus anyway, and some contributors have also said that having to comply with the employment requirements imposes considerable costs on the running of a superannuation fund, particularly when trustees have to check the employment status of people in certain age groups and overall, and also when it is the responsibility of the trustee to check that the employer is making the contributions, at least the SG contributions into the superannuation fund. So from our brief, which is one of analysing the cost-benefit impact of the SIS legislation, you could come at this angle about the employment nexus from a cost angle. I'm just wondering, in your experience and AIST's experience, whether the compliance with the employment requirements is a costly exercise, and if the employment nexus were broken, whether that would give any significant cost savings it would pass on to members?

MS RYAN: I think we'd be very cautious about agreeing with such a proposal, because a big thrust of the funds that are involved with AIST is to ensure that employers meet their obligations. For example, we are strong supporters of a proposal that employers should be mandated to contribute at least quarterly, rather than annually, so that employees are not left without their entitlements in the event of a bankruptcy or things of that kind. We also have supported moves to ensure that employers of casual labour do not fail to pay the SG there. So our focus has been very much on making sure employers fulfil their responsibilities to employees. So

the idea of breaking the nexus is quite a radical one.

I take the point about the spouse contribution arrangements changing things, but it's quite a minor part of the whole superannuation regime. I don't know the numbers who take advantage of it, but a very small proportion of people in superannuation funds would be there because their spouse is making a contribution for them. It's not to say it's not important, and we greeted that as a desirable reform when it came about, but I'm not sure that I would use that as the lever for breaking the nexus. But I really think we'd need more discussion amongst our members, because as I said, for us, it's a radical suggestion.

MR FRENEY: I can understand very much what you're saying in terms of protecting the interests of the employees and the members of superannuation funds, that one of the foremost things is to make sure that the contributions are paid in accurately for them, and whatever sort of weakening of an employment nexus you might have, you wouldn't want to jeopardise that principal point.

MS RYAN: Exactly, yes, that's right.

MR FRENEY: Thank you very much.

MR COSGROVE: We may have interrupted you.

MR FRENEY: I'm sorry, I did.

MS RYAN: From the point of view of competition and whether our current arrangements encourage productive competition, there are two ways in which competition is relevant, able to be applied to super funds. There's a very high degree of competition among the service providers to the funds. As you are aware, most of the funds outsource their administration, their investment management, their asset consulting, the production of their printed material and so forth. Now, in that area the competition, I think, is healthy. We would like to see more of it. I mention in our submission the good effect of competition in that super funds, in particular the big industry funds, have been able to reduce costs of administration. I know there's discussion, sometimes animated discussion, in the industry about the real costs of administration as charged to members of those funds but undoubtedly there has been some cost containment because of competition. So that's good, and we would like to see more of it in terms of the charges by money managers.

When it comes to competition that we might anticipate through a legislated choice of fund regime, we are more cautious. We do believe that members should have more choice than they often have under present circumstances. We've not been able to support the specific bill that was brought forward primarily because its terms would have required a lot more administration and the requirement for an employer to offer specific kinds of choices and to develop key feature statements and all of those sorts of requirements we felt would not add value, but we are open to other suggestions for improving choice of fund. There is quite a degree of choice of fund exercised without mandating. Many employers do offer choice and that will happen

more and more, and you notice that funds are more and more marketing themselves in order to attract members who may choose to join them; I suppose, most noticeably, the Bernie Fraser ads which I usually see on a Sunday morning when I'm watching Business Sunday and the Sunday shows. I mean, that demonstrates that there is some competition now among funds. How much more there should be I think is a matter for discussion but we are certainly not opposed to broadening the choice that members have. I suppose our basic position is that if a member is in a fund which is not performing, that member should not be locked in. They should have another choice.

MR COSGROVE: Do you think there are any ways in which the SIS Act itself restricts competition inappropriately? For example, the requirements necessary to become an approved trustee. Is that okay?

MS RYAN: We wouldn't see that as an unnecessary restriction. As I said, we do accept a high level of regulation because of the nature of - - -

MR COSGROVE: Yes, as you were saying earlier.

MS RYAN: Yes, and we've recently had regulations strengthened through the reversal of onus of proof for breaches of SIS and the application of the Criminal Code to all breaches of SIS. We did suggest for the parliamentary committee that those changes may not be necessary but they've happened and we have to live with them, and in the end, if they have the effect of making super funds safer, we're not going to mount a campaign against them even though there are the cost factors.

MR COSGROVE: In fact I notice in - it might have been the supplementary document that you gave to us that the number of people offering themselves for election as trustees to the Coles Myer fund is one-third what it was three years previously. Now, you do mention the strict liability provisions in that context. Are you aware of any more general trend of that kind?

MS RYAN: I think that's typical. I think the Coles Myer example would be replicated across the industry. It's more and more onerous to be a trustee of a super fund and in order to keep up with your duties and your responsibilities, you really need as a trustee to spend a lot of time preparing for board meetings. We offer a lot of training and seminar assistance to trustees but then they have a struggle to find time to attend those and to prepare for their meetings. So it's not surprising to us that the numbers of people prepared to take up the responsibility is shrinking. We've actually made the proposal that our regulator might assist us in the educational task on a more systematic basis. We find that we're very limited in our resources but very ambitious in terms of what we want to do for our trustees, and where we have been able to get regulators to come and address our members on very important issues - like the reversal of onus of proof - it's proved very helpful to our trustees.

APRA provided two such seminars for us last year and although our trustees didn't like what they were hearing in the sense that their fiduciary responsibilities were going to be made heavier, they really appreciated the opportunity to hear from

the regulators themselves what they intended, why they believed these changes were necessary, and I believe they went away from those sessions much better informed. We've invited APRA to do some more seminars with us and they've agreed to do it, I'm very happy to say, but perhaps there's even a larger role for the regulatory bodies where they could provide expertise, research and so forth to help trustees know that they are operating within the SIS requirements.

MR FRENEY: Could I ask a question here please. I agree very much with what you're saying about the importance of having well-educated and competent trustees, and if I could just use this as a bridge to move on to the topic of licensing, which you say you're not particularly enthusiastic about. In a way I can think of licensing as being an extra step to strengthen the prudent management of superannuation funds in the sense that you can argue, just like education, that perhaps you can't afford simply to have well-intentioned people but that before people take over the role of being a trustee they should be well-informed and professional, to a point; not of being professional funds managers, not of being professional administrators but knowing what their obligations are and how to fulfil those obligations in the trusteeship role. So I can see that you can mount an argument that in many other professions and trades - none of us would want to have an unlicensed plumber to come to do our plumbing work or an electrician - and when you think of putting your lifetime savings into the hands of trustees, if I could use the analogy, we'd all be looking to be putting it into the hands of people who are qualified, and not simply well-intentioned, but able to do the job. So I could see that that's an option and obviously it's one that's written into the FSR now. I'd just be interested to have your comments on that, Susan.

MS RYAN: Look, we accept that there is a greater and greater requirement for trustees to be able to demonstrate to their fund members that they have the competence to carry out their duties. We have stopped short of asking for legislation that requires a certain certificate or ongoing qualification but we've come quite close to it. We've certainly considered it and I think we'll continue to consider it. We would certainly approve of strengthened requirements in a super fund's reporting obligation to report on the level of professional development, if you like, undertaken by trustees but this particular licensing arrangement has not been developed to match precisely the needs of trustees. It's been developed for providers of financial products.

We'd rather see a specialised sort of consideration of how to ensure a higher level of training trustees. I mean, we're very well aware that there are many trustees who do not undertake training. I mean, our institute has about 900 trustee members. Now, why haven't we got thousands and thousands? They're not required to be members. They're not required to do any of our courses. Therefore it's the committed conscientious trustees that come into our net. There are other training opportunities. ASFA provides a lot of training, but even so, they would not deal with anything like the majority of trustees. So the question is there, "How can members be comforted that trustees know what they're doing?" and we do support measures to encourage/persuade trustees to undertake initial training and then to undertake annual training to upgrade their qualifications. I was very interested to read the Myner's

report in the UK which was very critical of the general level of competence of trustees in the UK pension fund system. I don't think all of those - - -

MR COSGROVE: Excuse me, what report was that?

MS RYAN: M-y-n-e-r, Myner's. The UK government set up the inquiry really to look at institutional investors to see why they were such conservative investors. I think that was the general purpose and in the course of that the committee investigated the competence of trustees and they were quite critical of the level of competence. I think more trustees in Australia undertake training and there is more emphasis through ASFA and AIST on providing accessible tailored seminars and workshops, but nonetheless some of the criticisms that were raised in that report could be considered in the context of the competence of all trustees in Australia.

But getting back to the Financial Services Reform Bill, we think the particular licensing arrangements there aren't the best fit for trustees but we would be open to other ways of encouraging trustees to do more regular training and upgrading. We've put forward the idea of an industry-wide credential and we would be very happy to convene the development of that. At this stage we're held back by lack of resources. We've asked the government whether they would like to give us some of the superannuation levy to fund this development and we're still discussing that.

MR COSGROVE: It might be needed for other purposes.

MS RYAN: Well, that's right. But we can't fund it ourselves and if it were to be self-funded in the way that, say, the Institute of Company Directors' courses are, it would be out of the reach of a lot. You know, those sorts of charges that the Institute of Company Directors are able to make would not be realistic. We just wouldn't get trustees undertaking them. So we need some assistance and - well, we'll still hope for a positive response from the government.

MR FRENEY: I'll just take the opportunity to note quickly, if I could, that ASFA has introduced a system of professional accreditation which is available for trustees, as I understand it, so that this is another step towards industry itself taking the initiative to enhance professionalism among industry service providers and including trustees.

MS RYAN: That's right, and we think that's a good initiative of ASFA's but we would like to develop something that was more specialised, that was trustee focused. The ASFA credentials were available to everyone within the industry.

MR FRENEY: Right.

MS RYAN: So we'd like to get something that was more tailored to the particular needs of trustees and to the particular needs really of those trustees who do not otherwise have the relevant knowledge and experience.

MR COSGROVE: While we are on this question of trustees, Susan, could I ask a

question which is something in the nature of a devil's advocate question: in your paper to us, you say at one point that representative trustees add value to the system, and we've certainly heard that from a number of people, not just your own institution. But you go on to say they're completely independent and have no conflict of interest. When you think of trustees who are either employers or in some cases - certainly not always - nominees of the relevant trade union, would you still say that they're approaching their role completely independently?

MS RYAN: I can't work out where there would be any conflict of interest in the way they fulfil their sole purpose test, which is investing the money to maximise the retirement benefit - - -

MR COSGROVE: Of the members, yes.

MS RYAN: An employer or an employee trustee may have other matters. I mean, union trustees may well have industrial relations matters in their mind or employers likewise may have the same matters in their minds.

MR COSGROVE: Yes, indeed.

MS RYAN: But when it comes to sitting round the trustee board table and administering, making decisions about death benefits, disability benefits, I can't see where conflict arises. I make the contrast, I suppose, where you have a commercial provider of a superannuation product and that commercial provider needs to meet the needs of the people who purchased the product but they also have to generate profits so as to be able to pay a dividend to shareholders, and that could provide a conflict of interest.

MR COSGROVE: Although we were told by an earlier participant today that the Managed Investment Act actually requires them in such a situation to give priority to the interests of the members of the fund which they are operating. As I say, it was a kind of devil's advocate question but I just - - -

MS RYAN: Yes, I think it is - - -

MR COSGROVE: It's very difficult for us to get a practical handle on the way in which trustee boards and members of them operate.

MS RYAN: The other relevant aspect of the corporate governance of the trustee boards is that they have 50 per cent representation from employer/employees but they must have a two-thirds majority to make any decision. Now, I understand that usually decisions are made by consensus but if, say, the employers were pursuing something that wasn't totally related to the sole purpose, then they - - -

MR COSGROVE: They run into a bit of resistance.

MS RYAN: That's right, and I think that structure has led to super boards being rather conservative in a lot of their practices, certainly in their investments, but on

the other hand, it's safe. So I think that really answers the conflict of interest issue as far as I can see it.

MR COSGROVE: That's an interesting point in itself, and you made it in your opening remarks, that you think the legislation or at least the operation of the boards under the SIS Act does produce conservative investment approaches. So we've heard suggestions to that effect from some people but I think a general view has also been that the legislation itself does not have that effect. It may be that it's in the nature of people carrying responsibility that they don't want to be seen to be taking undue risks. On the other hand, if you're thinking about the long-term retirement income of the members concerned, then depending on their age, you probably would want to be taking a growth-type of portfolio to induce higher returns over the long run - - -

MS RYAN: You would, and part of our education role at the institute is to expose trustees to alternative investments. We've been very busy in the last few months doing just that, putting on seminars with private equity - well, infrastructure has taken off now. That's sort of got itself established as an asset class that trustees are more comfortable with, property, but private equity is still something that trustees are very nervous of and you are quite right to suggest that their long-term earnings are likely to be improved if they're able to include a reasonable amount of private equity in their portfolio, so that's true.

But if you look at the history of the trustee boards as they're currently constituted, I think they were, from the outset, very aware of their fiduciary duty for the sole purpose test and so forth, and when they invest in big publicly-listed companies, they can take a very high level of comfort from the fact that they're listed on the stock exchange. There are other regulators. I mean, I suppose today if they had invested in HIH, that level of comfort would have drastically reduced but generally speaking, trustees were very comfortable about investments in those big public companies, whereas to invest in private equity, how do you do due diligence? They're not listed. They're different kinds of companies. They don't have a track record. So it's all much harder.

MR COSGROVE: Yes, I wasn't really thinking of private equity in the sense I can now see you are referring to it. It's more a question of should a retirement income's portfolio include a number of blue-chip Australian or foreign equity corporations and maybe a bit of commercial property as well - you know, more or less orthodox areas of long-term investment choice.

MS RYAN: Look, very few portfolios are anything other than that. Some have been a little bit more - - -

MR COSGROVE: Cautious.

MS RYAN: - - - adventurous and some have been more cautious but if you go through annual reports of super funds and look at their asset allocations, it's pretty similar. You don't see too many moving away from the established pattern.

MR COSGROVE: I think you've pretty well covered the questions that I had but let me have a look at the supplementary document.

MS RYAN: The supplementary, I thought that might be - - -

MR COSGROVE: This has come from a member, I realise, yes.

MS RYAN: - - - interesting to you because it's come from a member and she is talking about her particular fund and I thought that might be more interesting to you because my submission is pretty general.

MR COSGROVE: Yes, one significant point in this, I think, is the statement that:

> Costs arise in keeping up to date with and implementing procedural and policy changes to ensure compliance with the legislation.

This is another point that's been raised with us by a number of people, that it's not so much a question of complying with a particular piece of legislation, it's having to comply with more or less regular or frequent changes to it.

MS RYAN: That's right.

MR COSGROVE: Which can be difficult for a number of people, not just funds - administrators and so on. Yes, I realise this has come from a member of yours and not from you personally but at the top of the second page, it's numbered 2, the short text page, there's this statement that:

> A light-touch regulatory regime such as that proposed for privacy would seem to be a better alternative than the possible move to self-regulation or even the Managed Investments Act.

I don't know much about the privacy legislation but I was wondering, apart from the notion of light touch, whether there was anything more that we were meant to be understanding here. Do you know?

MS RYAN: I would interpret that to mean prudential rather than prescriptive.

MR COSGROVE: But I guess the emphasis is on light touch rather than a high degree of prescriptive - - -

MS RYAN: Yes, we had a big debate about prudential versus prescriptive in the context of the changes to the Criminal Code and the reversal of onus of proof and I think that the light touch or the prudential is where the regulator sets the framework but really adopts an educative role so that they go and look - - -

MR COSGROVE: Rather than dictating what must be done - - -

MS RYAN: And when they go and investigate a fund and they find that some

things are not correct, that instead of immediately declaring a breach, they say, "Look, you really need to improve your audit committee," or, "You should have a higher level of compliance procedures." So that's what we mean, where the regulator is in an educational partnership with the institutions to improve their performance rather than just - - -

MR COSGROVE: Blow the whistle on them, yes.

MS RYAN: - - - you know, three strikes or one strike and you're out.

MR COSGROVE: Yes. There was one other aspect here. It's on page 3. This was a response to the question in our issues paper about equal representation of employers and members in corporate funds. We went on to say, "Does compliance with that requirement involve any unwarranted costs?" Now, there's a clear statement there of some benefits resulting from equal representation but not much on the cost side. Are you aware of any costs? I mean, there's the training aspect, I guess.

MS RYAN: The costs are very low because the training - well, our fees are extremely low. In most cases, the majority of trustees still do not receive a fee. Fees are coming in, sitting fees are coming in. All the public sector funds pay them. I think the major industry funds do now; corporate funds tend not to. So you're not paying the trustees. You might spend a couple of thousand a year on their training requirements.

MR COSGROVE: Conducting elections, would that be a cost?

MS RYAN: There would be a cost there but I'm not sure - Coles Myer would be a good one to ask about that because they do conduct elections. In some cases the trustees are nominated as a result of agreements so they're not actually elected. Where they are, there would be a - or I could inquire. The fund I chair, which is the NRMA fund, conducts elections, so I could undertake to find that - - -

MR COSGROVE: If you're able to drop us a line about that, that would be interesting.

MS RYAN: Right.

MR COSGROVE: What else? Yes, the question of multiple regulators as mentioned on page 4, "Is regulatory oversight of superannuation trusts cost-effective?" No, because there are - in my words - too many of them with different policy objectives, different agendas and differing approaches to regulation. Is this really what you call a significant problem for trustees or is it something that you have to put up with but it doesn't really trouble you too much?

MS RYAN: I think there could be more harmonisation. I think at this stage it's more a question of sort of scurrying round to make sure that each regulator is - their requirements are met. I think there could be more harmonisation between provisions

for company directors under the Corporations Laws and SIS. Often they're operating under two layers. They've got all their SIS trustee requirements and then - of course they are directors of companies in most cases - they've got a corporate structure. So perhaps there could be a harmonisation there.

MR FRENEY: In that same area I was intrigued by your member's comments about the communique to members that complied with SIS requirements but was taken to task by ASIC on the complaint of one member, and your member then went on to say:

> Why has ASIC not played a more prominent role in pursuing the recalcitrant trustees where the trustee is a body corporate?

I suppose that's the emphasis where the trustee is a body corporate, then ASIC would have a role in disclosure and communication with members or with - no, it's more with shareholders. I was just a little bit curious about this comment. I don't know if you have a copy of it

MS RYAN: Where is that comment?

MR FRENEY: It's towards the bottom of page 4 of your member's supplementary note.

MS RYAN: Yes, that's right.

MR FRENEY: She was citing the Coles Myer example of having been taken to task by ASIC and then went on to say:

> Why has ASIC not played a more prominent role in pursuing the recalcitrant trustees?

I wasn't quite sure what your member was alluding to.

MS RYAN: To tell you the truth, I'm not either. That doesn't quite follow.

MR FRENEY: I did have one more important question anyway, if you'd bear with me.

MS RYAN: Yes.

MR FRENEY: I was thinking that we've had a little experience now with the choice of investment opportunities for those funds that allow - and SIS allows - a choice of investment. It's interesting to think whether choice of investment is actually helping to facilitate competition sort of policy objectives and cost reduction objectives. It's my understanding now that members can, where it's provided, choose their preferred investment strategies and so you'd like to think that the master trusts and others who are providing these facilities, and indeed industry funds that are providing these facilities - that an element of competition might come in, and so help

to lower the costs of administering or being the funds manager where there is a choice. So you'd like to think that (a) there might be some enhancement competition and (b) some benefits from cost reduction. I was just wondering, Susan, whether in a practical sense your members are seeing any of that yet or is it a bit too early?

MS RYAN: I believe there's an enhancement of competition arising from investment choice. I believe that big funds now feel that they must provide a degree of investment choice or they will lose members. I can give one example which I think has been a successful sort of trailblazer and is causing other funds to want to follow suit and that is one big industry fund, HESTA, offered a green investment choice or an ethical investment choice through a fund that was developed which selected companies which were best of sector in terms of environment performance. HESTA, I understand, developed that investment choice after surveying their members to see whether members - what sort of investment choices they wanted, and a lot of their members said they wanted this sort of choice, so HESTA provided that sort of choice.

A very large number of their members then chose it and then I noticed many other funds looking around to see how they could compete because there seems to be - well, certainly in the survey we do of our trustee members every year, we found a high degree of interest in such choices. Not all funds provide it yet, but they will, so competition is certainly - the existence of investment choice is allowing funds to become more competitive. As to whether there are cost savings, I suppose there would be costs too in initially developing the choice and there would be administrative costs involved when members switch their choice which I think generally they're allowed to do on an annual basis. I know that trustees wonder that if there's choice of investment strategies exercised very frequently, whether the costs will outweigh the benefits - in fact members don't switch very often, but they may in another environment. In the United States apparently they switch daily and our trustees go very pale at the thought of that.

MR COSGROVE: The costs of switching I think are lower there.

MS RYAN: They are. They go on the Net and just do it themselves. The other interesting question about the provisional investment choice is does this reduce some of the fiduciary risks for the trustee? If you've chosen to go into a high-risk, high-return fund and in this particular year it's no return, which has happened with some of the growth funds, it's hard to see that you could have a complaint against your trustee because you chose it. If your trustee had just put you there, you might have a complaint. So that's a sort of a topic for discussion among trustees at the moment.

MR COSGROVE: But if you're investing in a growth fund you'd want to be taking a view which was longer than one year, I think.

MS RYAN: That's right.

MR COSGROVE: They're bound to have the odd bad year.

MS RYAN: That's right. The level of knowledge and sophistication is not great, so people might still be disappointed. Even though they're supposed to wait for another 15 years to get the benefit of their choice, they still might be disappointed when they get their annual report.

MR FRENEY: If I could just follow up. I understood what you said that investment choice might have an initial - - -

MS RYAN: Cost.

MR FRENEY: - - - cost impact, and an adverse cost impact, but I'm just wondering in terms of an ongoing sense and competition sense that if members are free to choose between funds, my understanding is there probably has been intensified service or better service has derived from choice, and I'm just wondering whether choice has actually caused any competition to lower the ongoing administration of investment management fees that might be charged.

MS RYAN: Choice of fund or - - -

MR FRENEY: Choice of investment.

MS RYAN: I'm just trying to think, how would it come about that it would lower the - - -

MR FRENEY: If members are able to choose between different industry funds or master trusts as to where they place their money, whether there would be competition by the master trusts and the industry funds to attract that money - - -

MS RYAN: Yes.

MR FRENEY: - - - and whether one element of the competition is that they would actually lower their investment management fee structure or their administration fee structure.

MS RYAN: Yes, I see.

MR FRENEY: I have heard it said - to repeat myself - that they are addressing this choice by improving their services, as you were saying, giving members the opportunity to deal on line and all that, but I was wondering if it was coming through in a lower cost of fee structure.

MS RYAN: I might be in a better position to answer your question soon. AIST has commissioned a survey of fees and charges across the board - master trust industry funds, corporate funds. It's been carried out in the economics department at the University of New South Wales.

MR COSGROVE: Yes, I think you mentioned this to us when we spoke to you on

the phone.

MS RYAN: That's right. Yes, Dr Hazel Bateman is doing the research.

MR COSGROVE: Yes.

MS RYAN: We are expecting it any day and we'll certainly make it available to you. We hoped to have it available to you now but we haven't got it - but we'll get it. When would it be - - -

MR COSGROVE: If it comes to us during the course of this month, I'm sure that would be okay from our point of view, Susan.

MS RYAN: We're very keen to get it and that will be data. I mean, I can give you anecdotes but that will be data.

MR COSGROVE: No, that would be good.

MS RYAN: The industry funds in particular do market themselves as providing a better service for lower costs. Now, some of that is the administration. Some of it would be investment management. I mean, they do try to reduce the investment management but the reason why we commission this research is that for the member of a fund seeking to make an investment choice or seeking to decide to leave that fund and go to another, it's very difficult to compare what you're paying. It's not apples and apples at all.

MR COSGROVE: No.

MS RYAN: So is it 1 per cent or 1 and a half per cent, but 1 and a half per cent of what and for how long? So we find that a very confused area. We probably can't give you a good answer on cost but we hope that Dr Bateman's research will help you.

MR COSGROVE: Thank you very much. Susan, I've got to keep an eye on the clock from the point of view of our own travel arrangements but I don't want to deny you the opportunity to make any further points that you haven't already made.

MS RYAN: Our points are fairly general. I think I had hoped when I spoke to you earlier that we might be able to get some actual data from our members. We haven't been able to do that.

MR COSGROVE: No, I think it's very difficult, conceptually anyway - - -

MS RYAN: Yes, it is.

MR COSGROVE: - - - to design the information that we ideally would like for our inquiry. We've given some thought, since we spoke to you on the phone, to it ourselves and I must say we're sort of tending to think it's in the too-hard basket

really.

MS RYAN: It's very hard, and from our point of view we simply don't have the resources to design and gather the data. We'd be happy to get some of our trustees to have a workshop with you about how that might happen but we haven't been able to do it. So in conclusion, we support the current regulatory regime. We would like to see trustees better educated, more continually and regularly updated. We would be seeking some assistance from the regulators and from government to achieve that.

MR COSGROVE: Okay. That's well understood.

MS RYAN: And thanks for the opportunity to talk to you.

MR FRENEY: Thank you very much.

MR COSGROVE: No, thank you very much for coming along and providing the written material that you have for us. It's a helpful input to the inquiry.

MS RYAN: I'll look forward to your report.

MR COSGROVE: Yes, we'll be sure to give you a copy.

MS RYAN: Thank you.

MR COSGROVE: That concludes our hearings here in Melbourne, so we adjourn.

AT 3.45 PM THE INQUIRY WAS ADJOURNED ACCORDINGLY

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